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CONFLICTS ARISING IN THE INTERFACE OF PATENTS,  
TRADE SECRETS, AND COMPETITION LAW

by



VICTOR BRADSHAW GLEESON

A THESIS

SUBMITTED TO THE FACULTY OF GRADUATE STUDIES AND RESEARCH  
IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE  
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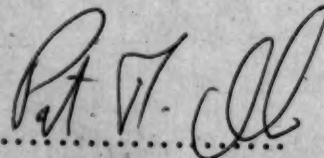
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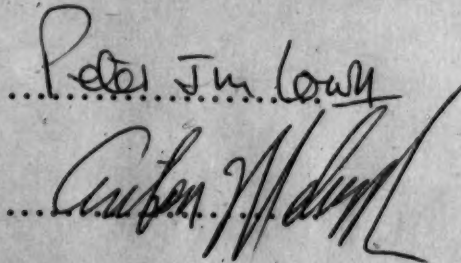
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ARISING AT THE INTERFACE OF PATENTS, TRADE SECRETS AND  
COMPETITION LAW submitted by VICTOR BRADSHAW GLEESON in  
partial fulfilment of the requirements for the degree  
of Master of Laws.



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## ABSTRACT

Patents provide an exception to the normal freedom of trade that is supported by competition law. Difficulties arise in limiting the use to which a patent monopoly is put lest the stimulus of innovation which patents are designed to achieve is counterbalanced by an over-encroachment on principles of competition law. A situation where there should be little difficulty in determining that an overencroachment has taken place is when a patent lacks validity due to a failure to satisfy the requirements of patent law. This observation has been to a great extent overlooked, however, in the evolution of the common law doctrine that the licensee or assignee of a patent is estopped from denying the validity of the patent. The doctrine has emerged from application of the rules of the law of contract that were in existence during the early evolution of the doctrine. A closely related doctrine of slightly different origin is that the assignor of a patent is also estopped from denying the validity of the patent in a dispute with the assignee.

The manner in which the estoppel doctrines developed is examined and the appropriateness of the doctrines on a party to party basis is discussed. The interest that the public at large may have in setting aside an invalid patent and the effect that the estoppel doctrines have on the broader public interest is considered.

Trade secrets have subject matter that can be very similar to that of patents although their subject matter may not be such as to qualify as patents. By comparison with the tests for patent validity the tests that have been developed to determine whether something can be



properly characterised as a trade secret are very vague. Whilst more limited in scope than patents the protection of trade secrets can bring about significant restraints of trade. This cannot be justified in the way that patents can be justified in that trade secrets are not given over to the public domain after a limited period.

The development of the law of trade secrets is traced. A feature of this development is the manner in which compartmentalization has occurred with considerations of protecting confidence and good faith being made with little regard for the effect this may have on restraint of trade. Finally some reflections are made on the way in which patent rights and trade secrets tend to be packaged and the problems that can arise if patents are subject to controls from which trade secrets remain immune.

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## CHAPTER ONE

### 1. Competition Law and Patents

Patent law has a common goal with some aspects of competition law: the stimulation of innovation. The method of achieving this goal puts them into conflict, however, in that the patent grant makes it an exception to what would normally prevail under competition law. This brings about the situation that the greater the competition in a particular field the greater is the value of immunity from competition brought about by a patent grant and hence the incentive to gain a patent is increased. That is, the strength of patent law depends on the degree to which it conflicts with the normal thrust of competition law.

Artificial restraints on the ability of persons to enter markets has always been a prime target for persons concerned with competition policy. Because the patent grant gives the patentee a right to exclude others from making, using or selling the patented invention, it constitutes a complete bar to entering the field covered by the patent. It was during the time of rapid industrial change in the second half of the nineteenth century that patent laws of the general character of today's patent law replaced the rudimentary patent laws that existed in the United Kingdom, Europe and the United States of America up until that time.

There was fierce public debate at that time between supporters of patents and free traders as to whether patents warranted the status of exceptions to the normal rule. Descriptions of the history of these battles and the economic arguments put forward are to be found in the work on this topic by Penrose<sup>1</sup> and by Machlup.<sup>2</sup> Machlup notes that the main points on which debates have centred since that time had not changed.<sup>3</sup>

Some light has been thrown on matters which had previously been mainly assertions alone in the work of Taylor and Silberston in the United Kingdom<sup>4</sup> and Firestone in Canada.<sup>5</sup> These works drew on material derived from extensive surveys of industry and were prompted respectively by the Banks Committee on the Patent System<sup>6</sup> and the brief to the Economic Council of Canada to report on Intellectual and Industrial Property.<sup>7</sup>

<sup>1</sup> Penrose, Edith T. "The Economics of the International Patent System" (Baltimore: John Hopkins Press, 1951).

<sup>2</sup> Machlup, Fritsch "An Economic Review of the Patent System" prepared for The Subcommittee on Patents, Trademarks and Copyright of the Committee on the Judiciary, United States Senate, 1958.

<sup>3</sup> Ibid p.22

<sup>4</sup> Taylor C.T. and Silberston Z.A. "The Economic Impact of the Patent System - A Study of the British Experience" (Cambridge U.P. 1973).

<sup>5</sup> Firestone O.J. "Economic Implications of Patent" (Ottawa U.P. 1971).

<sup>6</sup>

<sup>7</sup> Economic Council of Canada "Report on Intellectual and Industrial Property, Information Canada, 1971.

In these works there is some canvassing of the basic question of whether the patent system should be maintained. Modifications are suggested but in the absence of clear alternatives that would satisfy some of the desirable goals that the patent system attempts to satisfy no fundamental alterations are suggested.

This thesis does not attempt to explore the basic question of whether maintenance of the patent system is appropriate. It is concerned with what can be regarded as a fringe area of patents, albeit a fringe with an important practical impact. This fringe is in the area of licensing and assigning of patents and matters related to patents. Some further background may put the specific topics of this thesis in perspective.

If one accepts that a patent system of the general character of that in use in the United Kingdom, Canada and the United States of America should be maintained one is still confronted with the problem of the extent to which the patent owner should be permitted to go in exploiting his monopoly position. This can be viewed from two angles. One is the use of the patent in a direct yet negative fashion. This is the use of a patent to keep persons out of the market with the patent holder himself making virtually no exploitation of the invention covered by the patent or the use of it to make limited exploitation of the invention with consequent increase



of the price of goods made under the invention due to their scarcity. The other angle from which problems emerge is when use is made of the patent and advantage is taken of market strength to extract terms on matters that are not directly related to the patent. That is, a person may be licensed to use the patent but only on the condition, say, that other goods are purchased from the patent holder.

The above types of activity are regarded as "abuses" of the patent monopoly right and for many years the United Kingdom<sup>8</sup> and Canadian<sup>9</sup> Patent Acts have attempted to provide remedies for such activities. In Canada there is also a provision of the Combines Investigation Act which is levelled against an overreach of the rights conferred by a patent.<sup>10</sup>

Under the Canadian Patent provisions, two remedies are available if abuse of rights are established. The Commissioner of Patents may order the grant of compulsory licenses or, in extreme cases where the Commissioner is satisfied that a compulsory license cannot remedy matters, he may revoke the patent grant.<sup>11</sup> Similarly the use of a patent to unduly limit competition may result in the Exchequer Court of Canada making a direction under S.29(g) of the Combines Investigation Act that licenses be granted or the patent be

<sup>8</sup> Sections 37 - 41

<sup>9</sup> Sections 67 - 71

<sup>10</sup> R.S.C. C.314, s.29

<sup>11</sup> Section 68

revoked. The Exchequer Court also has available the possibility of declaring void any provision in any patent license that unduly limits competition or restraining any person from exercising any such term of a license.<sup>12</sup>

Compulsory licensing has never been available under the United States Patent Act. Through rules that have evolved from anti-trust law, however, there are some very significant limitations on the manner in which patent rights may be exploited. It is possible that many of these limitations apply to Canadian law also as the broadly expressed legislative provisions could be so construed as to embrace them. In the absence of any significant case law in Canada in this field this can be conjective only.

A major practical distinction between the position in Canada as against that in the United States of America is the difficulty a licensee or potential licensee faces in taking effective action. In the United States of America an anti-trust action for triple damages may be brought by a person alleging that a patentee has gone beyond the bounds of what is accepted as legitimate exploitation of a patent. No such remedy is available in Canada. Under the Patent Act provisions relating to abuse of exclusive rights, section 67(1) permits application by the Attorney-General or an interested person to the Commissioner of Patents with

<sup>12</sup> Section 29(e), (f).

a request for relief. Such an application can only be made after three years have passed since the grant of the patent. Furthermore, relief is limited to the Commissioner granting a compulsory license or revoking the patent. These potential sources of relief may be of assistance to a person interested in gaining a license from a patentee who is not exploiting his patent in Canada and is not willing to negotiate reasonable licensing conditions. They will be of very little assistance, however, to a person who wants a license at an early stage of what is a patent's effective life. Any license negotiated at such a stage will be negotiated with the patentee very much in a position of strength. He will not need to be conscious of the daunting repercussions of a triple damages action at a later time if the conditions exacted are overburdensome.

Three of the abuse of rights provisions under the Canadian Patents Act specifically relate to licenses. If trade is prejudiced by a refusal to grant a license under reasonable terms and it is in the public interest that licenses be granted, this constitutes an abuse.<sup>13</sup> So too, if a license has been granted and trade is prejudiced by conditions attached to the license.<sup>14</sup> Finally, it is an abuse of a patent to use a patent relating a process to unfairly prejudice the manufacture use of sale of unpatented materials used in the process.

<sup>13</sup> Section 67(d)

<sup>14</sup> Section 67(e).



There is a very limited number of Canadian cases resting on these provisions. The related provisions of the United Kingdom Act<sup>15</sup> are very similarly worded, however, and hence there is a body of English case law that throws some light on their interpretation. What does emerge from these cases is the difficulty of extracting rules of general application and the problem in demonstrating that an individual's difficulties in entering a trade prejudices trade overall.<sup>16</sup>

No further exploration is proposed on the scope of these provisions in that there is one type of restriction on which concentration will now be centred. This is a restriction whereby a patentee purportedly binds a licensee to refrain from arguing that there is an abuse of the patent. No cases are known where this has been attempted in a direct fashion but in what seems to be an indirect way of achieving this it is a matter of standard practice. This is brought about by a licensee being prevented from challenging the validity of the patent.

If one returns to basic principles the justification for permitting patents to be an exception to the normal freedom of trade is in order to stimulate innovation. The inventor may be encouraged to invent by the knowledge that the grant of a patent on his invention will permit him to exclude others from using it. The

<sup>15</sup> Section 37(2)(d) and (e)

<sup>16</sup> See particularly Brownie Wireless Co. Ltd.'s Applications (1929) 46 R.P.C. 457.

exploitation of the invention may require high costs in setting up a manufacturing process and possibly involve high initial costs in marketing. The umbrella from competition provided by the patent may encourage this. Society will possibly be advantaged immediately by the exploitation of the subject matter of the patent and may be further advantaged when the limited term of the patent monopoly comes to an end and everyone is free to use its subject matter. If these objects are not being achieved due to the subject matter being something that is already known, then unless there are other policy reasons for doing so - as with tariff barriers - there should not be any exception made to allowing free use of the subject matter.

There are certainly problems to be found in drawing the line between proper use of a patent monopoly and use that goes beyond this and constitutes an unacceptable encroachment on competition law. Difficulties in characterising the proper or legitimate use of the monopoly immediately arise. These difficulties should not arise if it is discovered that the matter should not be covered by a patent monopoly at all. In such a case no exclusion of others from exploiting the subject matter of the patent should be permitted and hence a right that flows from the right to exclude, the right to permit use only upon provision of some consideration, should not be permitted either. This would appear to be a truism unless there are compelling reasons to be found elsewhere for permitting such activity.

## 2. Invalid Patents

Upon issue by the Patent Office the Patent Act gives a patent the status of prima facie validity.<sup>17</sup> It is subject to adjudication by any court of competent jurisdiction.<sup>18</sup> If the holder of a patent alleges that unauthorised use is being made of the subject matter of the patent he may bring an infringement action against the user and it is open to that user to raise the defence that the patent is invalid.<sup>19</sup> A successful defence on this ground will operate only on the particular action, however, and if the patent is to be completely set aside, it is necessary for a patent to be declared invalid or void by the Exchequer Court following an impeachment action.<sup>20</sup> An impeachment action can be brought either by the Attorney General or "any interested person."

The scope of "any interested person" is said to be wide.<sup>21</sup> It would seem that anyone wishing to use anything described in a patent may bring a challenge. There is an important class of persons, however, who apparently cannot bring action to impeach a patent. Licensees under a patent are said to be estopped from denying the validity of the patent.

<sup>17</sup> Section 48

<sup>18</sup> Section 46

<sup>19</sup> Section 61

<sup>20</sup> Section 62

<sup>21</sup> See E. I. DuPont de Nemours & Co. v. Montecatini-Societa Generale Per L'Industria Mineraria E. Chimica (1966) 49 C.P.R. 209; (1967) 52 C.P.R. 18 and the cases gathered therein.



The estoppel that acts to prevent a challenge on a patent's validity by a licensee arises from a common law rule that has evolved in a curious fashion. A detailed analysis of the development and present status of this rule is made in Chapter 2 of this thesis. A result of licensee estoppel is that a licensing agreement can have the effect of bringing about obligations which would probably not be enforceable unless they were based on a patent yet no query can be made of the soundness of this base.

There is a well known observation with respect to the law of gravity and Newton's third law that has at times found application in the legal field. It is a rejection of a "bootstraps" (inability to pull oneself up by) argument. The licensee estoppel rule in patents seems to be an exercise in bootstrapping. If an agreement was entered whereby a manufacturer of say, a common household article agreed to refrain from manufacturing the article unless he made payments to another person, it is most unlikely that the agreement would be enforceable. For one thing, there would be a total failure of consideration. For another, the agreement would be unenforceable as being against the common law rule against restraint of trade and possibly if trade overall was significantly affected, it may be an infringement of legislative provisions that, in the Canadian context, are to be found in the Combines Investigation Act. These difficulties will be displaced

if the person to whom payments were to be made was the holder of a patent that embraced the article in question. But what should be necessary here is that the patent be a valid one, in that rights ascribable to a patent should not be available to something that does not satisfy the requirements of a patent. To allow otherwise would be "bootstrapping". For this to be justified, there would need to be other strong policy grounds which do not emerge from the cases reviewed in Chapter 2 of this thesis.

Whilst the Canadian Patent Act, in common with the Act of United Kingdom, United States of America and Acts of other countries that follow the English system, gives a patent only prima facie validity and provides procedures for challenges to be made the way in which a challenge takes place in Canada leads to different results. An impeachment action, if successful leads to the patent being set aside. A challenge to validity which is made only as a defence to an action for infringement by the patent holder will affect only the inter partes relationship.<sup>22</sup> The only way that a declaration in rem may be gained is through instituting a separate action in the Exchequer Court under Section 62 of the Act. The United Kingdom, with no difficulties arising through a federal system, does not make a multiplicity of actions necessary as one section of the United Kingdom Patents Act covers action for

<sup>22</sup> Maw v. Massey-Harris Co. (1902) 14 Man R. 252; Hemsworth v. Charlton (1927) 32 O.W.N. 302; Flexlume Sign Co. v. Macey Sign Co. (1923) 54 O.L.R. 669 affirmed [1924] 4 D.L.R. 49 (Can.)

revocation and defence to an infringement action.<sup>23</sup> Since the case of Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation<sup>24</sup> was decided by the United States Supreme Court, in most circumstances a United States patentee who has had a finding of invalidity made on his patent in an unsuccessful infringement action will be unable to later bring actions under the patent.

One may consider the position of a businessman in Canada who has had his attention brought to the possibility that his current or planned activity may constitute an infringement of a patent. He may decide to refrain from the activity altogether which will be the end of the matter except for the set-back that he may suffer by doing so and the set-back that society may suffer, especially if the patent does not happen to be a valid one. Alternatively he may decide to continue with the activity without authorisation by the patentee and await an infringement action. This will be with the knowledge that an infringement action will be expensive to defend in any event<sup>25</sup> but will be even more expensive if lost as damages and/or accounting of profits may be ordered together with the potential loss through having an injunction ordered. The knowledge that there may be other infringers whose activities may be subject to action by the patentee will be of little impact in that the patent will not be set aside unless one of them decides to bring an impeachment action rather than merely

<sup>23</sup> Section 32 and see section 32(4)

<sup>24</sup> 402 U.S. 313 (1971)

<sup>25</sup> See Firestone "Economic Implications of Patents" pp. 50-56



defend an infringement action. This makes an impeachment action by the businessman himself seem a sensible solution except for the practical considerations against it. These considerations are the multiplicity of impeachment actions that may be necessary if every patent that impinges on the businessman's normal operations is to be challenged and, in the light of the high cost of any action along these lines, the wastefulness of such activities if the patent owners are not particularly active in policing their rights. There is also the practical consideration that a challenge or series of challenges against technically advanced organisations that tend to have large patent holdings will do little towards gaining licenses and technical assistance when these may be needed on future occasions. Therefore, the most prudent course would seem to be to attempt to negotiate a licensing arrangement if the patent holder appears to be seriously contemplating an infringement action.

The bargaining strengths of the parties engaged in negotiating a license will reflect the financial strength of the parties and the strength of the patent. In Canada, with ninety-five percent of patents owned by non-residents<sup>26</sup> there is a high chance that a locally-owned potential licensee in Canada will not be negotiating from a position of financial strength.

<sup>26</sup> Per R.M. Davidson, Department of Consumer and Corporate Affairs, Patent Law - Licensing of Patents and Know-How 1975. Law Society of Upper Canada p.25

On the aspect of the strength of the patent, this will be related to the strategic position it occupies in its field and its possible or probable validity if challenged. The latter will be hard to estimate until the patent has been worked for some time.

The requirements for validity of a patent are not exhaustively defined in the Canadian Act nor are the specific requirements conveniently grouped in one place.<sup>27</sup> This contrasts with the United Kingdom Act where, since 1949, the grounds on which a patent may be revoked are presented in the one provision, section 32. There is very little difference in the more important requirements, however, so the requirements for validity may be summarised as follows:

- (1) Novelty - no prior use or prior publication of the subject matter of the patent.
- (2) Lack of obviousness - there must be an inventive step such that the subject matter would not be obvious to a competent person engaged in the art.
- (3) Utility - a useful purpose must be achieved with the method indicated capable of producing the result claimed.
- (4) Proper subject matter - must be an art, process, machine, manufacture or composition and not merely a principle or theory.

<sup>27</sup> For a detailed consideration of the statutory and common law requirements for patent validity see W.L. Hayhurst "Grounds for Invalidating Patents" (1975) 18 C.P.R. 222.

- (5) Application by actual inventor - a patent can only be obtained by the actual inventor or his legal representative.
- (6) Sufficiency of description - the description must be such as to permit a person skilled in the art to carry out the invention.
- (7) Claims are clear and supported by the description - the function of the claims is to define the scope of the monopoly and hence they must have clarity and also must not go beyond the invention disclosed.

Whilst in theory all these requirements for validity could be thoroughly checked before gaining a license under a patent the ordinary would-be licensee will often be unaware of matters that may later come to light. The Patent Office suffers from a similar disability in that even with technically skilled staff that has access to well classified resource material in the form of prior patents, it can often be the case that prior use or prior publication in a form other than a patent specification will not come to the attention of the patent examiner. Further, it is very difficult to determine whether a description provides sufficient information for the invention to be carried out until an attempt is made to follow the instructions.

The result that may flow from these circumstances is that a licensee may not be aware of any grounds of invalidity



at the time he enters a license but becomes aware of them later. Understandably this leads to some disenchantment by the licensee. Payment of royalties for something that he thinks may be invalid will be upsetting, even more so if the suspected invalidity is partially established by a successful defence by a third person who had been sued for infringement. Nonetheless, under the rule that has evolved on licensee estoppel, he will not be in the position to challenge the validity himself but will be open to an action by the patent holder if he fails to carry out the obligations placed on him under the licensing agreement. This situation will continue even if a third party establishes invalidity of the patent, in rem, by a successful impeachment action.

Certainly a situation where a patent has been impeached but a licensee remains obligated under his license provides an extreme case. This situation appears analogous to some of those mentioned by Roy M. Davidson who, as Senior Deputy Director, Bureau of Competition Policy of the Department of Consumer and Corporate Affairs, outlined<sup>28</sup> practices that may not be acceptable under Section 29 of the Combines Investigation Act, a provision that has received no direct judicial consideration. He stated that, inter alia, the following kinds of provisions have the effect of

<sup>28</sup> Paper delivered to Department of Continuing Education, Law Society of Upper Canada on Patent Law - Licensing of Patents and Know-How 1975, p.25

extending the patent monopoly and hence would be under scrutiny:

- "(1) the charging of royalties on patents after they expire.
- (2) other restrictions, relating to the subject matter of the patent or to know-how which continue after they expire.
- (3) the requirement that the licensee accept and pay for additional patents (to discourage a challenge to the validity of doubtful patents);....."

Similar comments were made with respect to provisions that arguably had the effect of entrenching the monopoly and exceeding the rights conferred by the patent grant

- "(1) restrictions requiring the licensee not to contest the validity of the patents involved;....
- ..... (4) restrictions requiring the transfer of any inventions or improvements to the licensor..."

As remarked earlier, the judicial reaction to such provisions in a Combines Investigation Act setting is not known. What is clear is that when approached from another perspective the courts in Canada have up to this time inadvertently permitted an extension of the patent monopoly, a monopoly which may later be discovered to be unjustified in the first instance, by refusing to allow a challenge of validity and not recognising even established

invalidity when a licensing agreement is under consideration. Although the initial patent may be invalid, conditions along the lines of those indicated by Davidson may be imposed and possibly extend the "bootstrapping" exercise.

What the licensee estoppel doctrine reflects is a focussing on the licensing agreement itself with no exploration being made as to how the agreement came about and little regard being had for principles of patent law and competition policy that may suffer. Some similar problems emerge with the assignment of patents with it being an established common law rule that an assignee of a patent cannot raise the issue of patent invalidity in a dispute with the assignor and nor may the assignor challenge validity if the assignee brings action against him for the patent he assigned. Licensing of a patent involves the patent holder maintaining his interest and granting the licensee an immunity from an infringement action that he would otherwise be able to bring. An assignment brings about a complete transfer of the patent rights. In practice very similar results to an assignment may emerge when the license granted is an exclusive one that goes to the extent of excluding the licensor himself. Nonetheless, with licensing being analogous to a hiring of "industrial property" and an assignment constituting its outright sale there are immediate legal differences and differences that flow through to the way that they may need to be handled. In an area where competing



policy interests abound, the policy head that may lead to patent licensing and patent assignments being treated differently arises under the head of the interest that the public has in patents.

There may be reasonable policy grounds for courts enforcing what appears to be a freely entered contractual arrangement in the way of a patent license or patent assignment. The question that arises is the extent to which these policy grounds should be permitted to overshadow another important policy requirement: only patents that satisfy legislative and common law requirements should be issued and allowed to subsist. Vast sums are outlaid from the public purse in the attempt to issue only valid patents but there is no practical possibility of every issued patent being a valid one. The expense incurred in attempting to approach what is probably unachievable, nonetheless reflects (or at one time reflected) an awareness of the mischief that could be brought about by the issue of patents that were not valid. Why then, does a situation arise in which persons who are very directly affected and have the knowledge and motivation to challenge a patent are denied the opportunity to do so?

The answer to this question may be found in compelling public policy grounds that are based on other considerations. Some of these possible grounds are canvassed in Chapter 3 of this thesis. The United States experience is educating in this regard as the intensity of litigation is such

that problems that are not frequently exposed in Canada have been subjected to judicial scrutiny and policy considerations have been weighed. The case of Lear Inc. v. Adkins<sup>29</sup> has had a great impact on the law in this area in the United States of America and the policy grounds on which it is based are worthy of close attention. In this case, the traditional common law rule of licensee estoppel was subjugated to the public interest consideration of permitting a challenge that may result in an invalid patent being put aside.

Lear v. Adkins saw the desirability of tapping the potential for challenges to validity from parties that could have a vested interest in a challenge through being a licensee. An assignee, through his ownership of the patent rights is caught with his own conflicting interests in contemplating a challenge on validity if such a challenge was open to him: a successful challenge may rob him of his dubious position as patent holder with only a distant possibility of making a recovery from the assignor of the patent. Whilst the public interest grounds in permitting an assignor to question the validity of a patent may run along similar lines to a licensee challenge, the assignor's position must be related to that of the assignee. Furthermore, an assignor may be readily distinguishable from a licensee on other grounds through having received consideration for the assignment. These issues are examined in more detail in Chapter 3.

<sup>29</sup> 395 U.S. 653 (1969).

### 3. Patents and Trade Secrets

Whereas a patent grant gives the holder a right to bring an action against anyone using the subject matter of the patent a holder of a trade secret gains no rights with the respect to the community at large. An independent discoverer of a trade secret is free to use it. A trade secret holder generally does have rights, however, as against persons who have learnt the trade secret from him. This can lead to a clash with competition law, mainly as reflected in the common law approach to contracts in restraint of trade. Whilst more subtle than the conflict with freedom of trade provided by patent law, the restrictions arising through trade secrets can have a significant impact in technologically advanced areas especially when the area is controlled by a monopoly or oligopoly.

Trade secret law is the result of common law evolutions, seemingly with no clear starting point. A search for the source of trade secret law is embarked on in Chapter 4 of this thesis. The result of this search has not revealed anything matching the source of the Nile but instead emerged with a "Topsy" of undetectable parentage and dubious upbringing with resulting unpredictable traits.

The close relationship of the subject matter of trade secrets with that of patents prompts comparison of the legal treatment accorded to them. This close relationship also



leads to a choice at times being available to the holder of a trade secret as to whether he will attempt to maintain its trade secret status or make it the subject matter of a patent. If the law was to reflect policy considerations one might hope to find that the choice between maintaining a trade secret and making a patent application was influenced by these legal considerations so that the desired policy goals were attained. As it now stands, trade secret law has emerged with very little regard to the alternative that may be provided by patent law.

The alternatives cannot be overlooked because patent law policies as reflected in current legislation can be undermined by trade secret law as too can various modifications suggested for patent law. With respect to patent licensing, there is little point in advocating compulsory licensing in many fields if a licensee will not be in the position to exploit the license due to a lack of knowledge of the trade secrets that are related to the subject matter of the patent. Licenses that are negotiated between the patent holder and the licensee can have a life far beyond the initial patent if the licensee is not permitted to use trade secrets related to the patent at the expiration of the patent term. This is just part of a problem that can arise when there is a license for the use of a combination of patents and trade secrets in that any limitations

that may be placed on patents to avoid abuse of the patent monopoly will be of little effect if the same limitations do not apply to the trade secrets.

As the law now stands, trade secrets are most inadequately defined by comparison with patents. Not only is there no requirement that a trade secret has novelty and lacks obviousness in the patent sense, but also there is no requirement that the scope of a trade secret be subject to the type of definition that is necessary in a patent claim. Added to this is the secrecy that is necessarily adopted in any trade secret litigation with the resulting difficulties that this presents to an adequate preparation of cases and the curtain that it places on scrutiny by interested and possibly expert parties.

In Chapter 4, the accent is given to the manner in which trade secrets affect the employer and employee relationship. Much of the litigation that has occurred in the field has arisen in disputes in this area and it is here that the clash with restraint of trade considerations is most apparent. Similar issues arise in subcontracting arrangements and licensing arrangements.

The obligations with respect to trade secrets that may be explicit or implicit terms of the contract of employment are significant in licensing agreements involving a package of trade secrets and patents, because it is a commonly

inserted clause in such agreements that the licensee bind his employees to secrecy. This affects employee mobility and with it affects the dissemination to the society at large of the methods of carrying out the subject matter of a patent. Frustration of this awaited advantage strikes at one of the main justifications for granting the patent monopoly.



## CHAPTER 2

### 1. Introduction

The effect of the Statute of Monopolies of 1623<sup>1</sup> was to render void all monopolies save those permitted for "any manner of new manufactures". Patent law evolved from judicial and legislative embellishments on what constituted a "manner of new manufacture" with requirements for gaining the limited monopoly for matters within this classification being modified as the law developed. One could say that if a patent does not satisfy the requirements of a valid patent, it is not really a patent at all and it should fall back with the residue of purported monopolies that the Statute of Monopolies was levelled against.

It would be a most desirable state of affairs for only valid patents to be issued. However, with the limited resources of even the best patent offices of today, invalid patents will continue to be issued due to limits placed on the literature searched for novelty and the difficulties of determining whether a full description has been provided.

An invalid patent may have very undesirable effects from the viewpoint of the common law against restraint of trade and the legislation that is designed to reduce restrictions on competition. A person who has an infringement action brought against him may take the opportunity of challenging the validity of a patent and if successful in his challenge, free the area from the anti-competitive

<sup>1</sup> 21 Jac. 1 c.3.

effect of the invalid patent. This possibility is generally not available, however, if the person in dispute with the holder of the patent happens to be a licensee under the patent. Similar limits apply to the assignee vis a vis the assignor. This result emerges because there is a general rule that a licensee or an assignee is estopped from denying the validity of the patent. There is also a rule with slightly different origins whereby an assignor is estopped from denying the validity of a patent in a confrontation with his assignee.

Recently, in the United States of America the Supreme Court ruled that the estoppel rule should no longer apply. The reason for this decision was heavily based on anti-trust considerations. In Canada and England the legislation and tradition in this field varies from that of the United States of America. Some parallels with the Supreme Court of America's approach will be drawn in the next chapter.

The object of this chapter is to trace the development of the estoppel rules with the hope of detecting their origins. The accent is to be on the inter-party relationship with the broader public considerations to be considered later. It may be that even without the broader considerations there are good grounds for reform of the estoppel rule.

## 2. Early development

The first significant case in the field is that of Hayne v. Maltby.<sup>2</sup> The approach taken by the members of the court is quite different from that adopted in later cases. It was subject to passing discussion in cases over the next half century, but in later cases it was "distinguished" in all sorts of ways until defendant counsel apparently despaired and it became buried in the lists of footnotes in the standard textbooks. As it may represent the way the law could have been, it will be examined in some detail.

The plaintiff was the assignee of one Taylor of a patent for a machine that was used for manufacturing net. The defendant had requested the plaintiff's permission to use one of the patented machines and an agreement was entered between the plaintiff and the defendant whereby the defendant was permitted to use the machine. There were covenants by the defendant in the agreement that he would use the machine only in the manner described in the specifications and that for the term of the patent he would refrain from using any other type of machine resembling the patented machine. The plaintiff brought an action on the covenant against the defendant stating in his declaration that the defendant had used machines other than ones covered by the patent. In response the defendant made several pleas and to three of the pleas the plaintiff demurred. It was on these demurrers that the case came before the Court of King's Bench.

<sup>2</sup> (1789) 3 T.R. 479; 100 E.R. 665.



All three pleas went to the validity of the patents.

In one plea the defendant set forth the letters patent which stated a petition by the patentee that he was the inventor of the machine and contained the usual proviso that they should be void if the patentee did not enrol a specification of his invention in Chancery in four months; the averment was that the patentee did not enrol the specification. In the next plea the defendant said that the invention mentioned in the patent was not a new invention. In the last plea under dispute the defendant stated that the invention was not the discovery of Taylor, the patentee.

The plaintiff's counsel, arguing in support of the demurrer, contended that the defendant was estopped by his deed to say that the invention was not new or that it was not discovered by the patentee. He argued that wherever a party has entered into a speciality he cannot afterwards be permitted to say that he received no consideration for it, although he may plead that the consideration was illegal. It was suggested that if, in point of fact, the invention was not new that the defendant should have repealed the letters patent by scire facias and then apply to the Court of Chancery to have the deed delivered up to be cancelled. However, the defendant had by his deed admitted the plaintiff's title and accordingly, as long as the term mentioned in it exists, he was estopped from denying it. The analogy was drawn between this situation and that of a tenant who cannot challenge his landlord's title in an action for rent.

The defence argument appeared to be based on three grounds. One contention was that a distinction had to be drawn between preventing a person from averring against a record as against going against the operation of it. Accordingly, the defendant may be estopped from denying that which is stated in the deed, namely that the plaintiffs were in possession of a patent but they were not estopped from denying the operation of it.

The limited notes given in the report of the defence arguments do not make the nature of the above point clear and as this did not appear to be an argument that was accepted by the court, perhaps little can be made of it. The impact of the argument may be that denial of the plaintiff's title in the patent may not be permitted but that it was possible to argue the validity of a patent because this went beyond title.

The second ground of the defence argument was that if the invention was not new the covenant made by the defendant was without consideration.

What could be regarded as a third ground of argument was based on public policy. It was said that if the covenant was not without consideration it was entered for an illegal consideration because it was in restraint of trade. Accordingly, as in Mitchell v. Reynolds,<sup>3</sup> the covenant being one without consideration or in restraint of trade generally is void. Alternatively, the public policy aspect

<sup>3</sup> (1711) 1 P. Wms. 181

could be directed against the issue of estoppel because it was argued that estoppel should not be applied to defeat a public policy issue.

In finding in favour of the defendant, it was the consideration aspect that received most direct attention. This in itself could be seen as reflecting a concern for public policy. The broader public policy issue of opposition to restraint being placed on the use of something that was not the subject matter of a valid patent is only implied in the judgments.

The Chief Justice, Lord Kenyon stated that the plaintiffs had purported to bestow rights under the patent to the defendant when in fact there were no rights that could be bestowed. He said

"...notwithstanding (this)....they still insist that the defendant shall be bound by his covenant, though the consideration of it is fraudulent and void. This is not to be considered as a covenant to pay a certain sum in gross at all events; but to use a machine in a particular way, in consideration of the plaintiffs having conferred that interest on the defendant, which they professed to confer by the agreement. Now, in point of conscience it is impossible that two persons can entertain different ideas upon the subject. But it is said that, though conscience fails, the defendant is estopped in point of law from saying that the plaintiffs had no privilege to confer. But the doctrine of estoppel is not applicable here ....Who is estopped? The person, supposed to be estopped, is the very person who has been cheated and imposed upon." <sup>4</sup>



Ashhurst J. distinguishes the situation from that where a tenant cannot deny his landlord's title "for he has a meritorious consideration." He stated

"But this is a case of a very different kind. The plaintiffs use this patent as a fraud on all mankind; and they state it to be an invention of the patentee, when in truth it was no invention of his. The only right conferred on the defendant by this agreement was that of using this machine; which was no more than that which he, in common with every other subject, has without any grant from the plaintiffs."

Buller J. made a similar approach to the question.

He said

"(the plaintiffs) came to an agreement with the defendant, by which they covenanted that he should be at liberty to use the patent machine, of which they were then in possession, provided he would use it in the manner therein specified; in consideration of which he covenanted not to use any other machine. But it is now discovered that they had no such right, and therefore the defendant has not the consideration for which he entered into this covenant."

Grose J. concurred with the other members of the court without stating reasons.

It is noted that both Lord Kenyon and Ashhurst J. mentioned the word "fraud" in their judgments. This has been subject to attention in later cases. It is noted, however, that defence counsel did not make any direct references to fraudulent activities and it seems that when used in the judgments the term was not to be given the connotation of a deliberate falsehood that was calculated to deceive. Nowhere in the judgments is mention made of a distinction

between an innocent and fraudulent claim of patent validity. It would seem that "fraud" is being used in an analogous sense to "Fraud against the Patent Office" as used in the United States of America today i.e. a deliberate deception is not essential.

In all three judgments, mention is made of the possible parallel to a tenant being estopped from denying his landlord's title. Because this parallel has received very heavy service in later cases, the treatment given to it here is of interest. It is pointed out that the tenant's estoppel only applies whilst the tenant continues occupation but should he be expelled by a person having a superior title, he may plead the issue of the title. The invalidity of a patent is regarded as equivalent to an eviction of the tenant.

Counsel for the plaintiff cited in support of his estoppel argument an earlier decision of Lord Kenyon in Oldham v. Langmead.<sup>5</sup> In that case action was brought by the assignee against the patentee who had later denied validity. Lord Kenyon distinguished that case on the basis that estoppel by deed could operate when the person estopped was the person who had conveyed the interest in the patent but then sought to deny his having had title to convey. That was not a situation where the person estopped was the very one who had been "cheated and imposed on". The manner in which this case is distinguished strongly implies that it is the failure of consideration that lies at the heart of the decision. Alternatively Hayne v. Maltby may be contrasted from Oldham v. Langmead on the basis that the defendant Maltby was not seeking to derogate from his own grant when

<sup>5</sup>sittings after Trinity 1789. Unreported.

he sought to challenge the validity of the patent. Viewed in that light, the lack of consideration aspect may be just part of the public policy issue and not as the core of the decision.

In Taylor v. Hare<sup>6</sup>, the next reported case in the area, consideration received much attention but its treatment varied substantially from the approach made in Hayne v. Maltby. There is no mention of Hayne v. Maltby in the judgments and the notes on the arguments by counsel for the plaintiff do not mention any cases. The court did not call on the defendant to argue.

There was no direct mention of estoppel in Taylor v. Hare. The defendant was the patentee of apparatus for preserving the essential oil of hops in brewing. He entered an agreement with the plaintiffs whereby the plaintiffs were to be permitted to use the invention for the residue of its 14 year term - a period of almost 13 years - with the plaintiffs to pay a One Hundred Pound annuity for the privilege. A bond was given by the plaintiffs, conditioned for the payment of annuity. The plaintiffs used the invention for almost four and one-half years and made regular payments amounting to Four Hundred and Twenty-Five Pounds when they discovered that the invention was not new in that it had been invented and publicly used in England by another party prior to the patent being taken out. The plaintiffs brought an action for the recovery of the Four Hundred and Twenty Five Pounds. It is mentioned by counsel for the plaintiffs that the defendant had already failed in an action on the bond in

<sup>6</sup> (1805) 1 Bos. & Pul. (N.R.) 259; 127 E.R. 461.



which the validity of the patent was put in issue.

No report can be found on how the defendant had failed in his earlier action. Presumably the plaintiffs had been permitted to challenge the validity of the patent. This would have been in accord with Hayne v. Maltby.

On the action for recovery of the amount earlier paid the Court of Common Pleas non suited the plaintiffs on the basis that the plaintiffs had received the benefit for which they had paid. The Chief Justice, Sir James Mansfield made an implied reference to mistake. He said:

"...two persons equally innocent make a bargain about the use of a patent, the Defendant supposing himself to be in possession of a valuable patent-right and the Plaintiff supposing the same thing. Under these circumstances the latter agrees to pay the former for the use of the invention, and he has the use of it; non constat what advantage he made of it; for any thing that appears he may have made considerable profit."

Chambre J. referred to mistake:

"Here both parties have been mistaken; the Defendant has thrown away his money in obtaining a patent for his own invention; not so the Plaintiff for he has had the use of another person's invention for his money."

These references to mistake being made by the parties do not appear to advance the defendant's cause more than excluding any possible suggestion of deliberate falsehood. The way that Chambre J. states matters the defendant's mistake would appear to be

an irrelevant one. The Chief Justice's approach would seem to rest on an exercise in construction of the agreement whereby he concludes that there was no implied term that the patent was valid.

What is of main interest in the judgments is the way in which consideration is seen to flow from granting the right to use an invention notwithstanding the fact that the invention was not embraced by a valid patent and hence it was available for everyone to use. In the remarks of the Chief Justice quoted above, it is said that the plaintiffs "may have made considerable profit" from using the invention. This would appear to be an irrelevant factor given the possibility of anyone else also being able to make considerable profit from exploiting the same thing. Perhaps the consideration is provided in a more subtle way for the Chief Justice also said:

"In consideration of a certain sum of money, the Defendant permits the Plaintiffs to make use of his invention, which he would never have thought of using had not the privilege been transferred to him."

This may be a satisfactory answer if it was shown that the patentee had provided advice, encouragement and other personal services, as well as the patent licence, but there is no indication that this was the case.

All in all, the approach to consideration seems confused. Heath J. grasps the landlord and tenant analogy and points to the possible injustice that would arise if a tenant could recover rent previously paid if he should at some time be evicted. This would

be unacceptable, in his view, because the tenant "has taken the fruits of the land". Heath J. does not see that a more apt analogy to the licensee of an invalid patent would be a tenant who was let public land which he could use with no greater effectiveness than any members of the public. The court in Hayne v. Maltby was capable of noting the sophisticated difference between an invalid patent and a flaw in the title of real property but that insight became lost.

Chambre J. was concerned at the great inconvenience that may arise if royalty payments had to be returned if a patent should be found invalid towards the end of its term. He did not address himself to the alternative source of inconvenience that may emerge if the holders of invalid patents could extract from them the same advantages as the holders of valid patents.

An issue that is not canvassed by the court is what should occur if the defendant should later sue for royalty payments for the eight and one half years that remained of the initial term. Much of the dicta would seem to indicate that the defendant would succeed. It is to be recalled, however, that the defendant had already failed in his action for the bond when the validity of the patent had been put in issue. In order to bring into some harmony the results of the contests between Taylor and Hare, it would seem necessary to give a narrower scope to the dicta than would be given to it on first impression. It could be put this way: A licensee should not be able to recover royalty payments that are paid for a



period when the patent is not known to be invalid; some consideration is provided in a license before there is a declaration of invalidity because although others may have been free to use the invention embraced by the patent, they are most likely unaware of this and hence will remain outside the area.

The above interpretation is in accord with the landlord and tenant analogy if the licensee happens to enjoy an absence of competition from persons who are not licensed under the patent. Unsatisfactory as this approach may be, especially in situations where there is strong invasion of the market due to the possibility of the patent being invalid is a matter of notoriety, it is seen as providing a better approach than that indicated by giving the judgments the wide scope that their wording implies. As will be discussed later, the suggested approach is broadly in accord with that adopted in the United States of America some 150 years later, although quite different reasoning was to support it.

The landlord and tenant analogy was subject to analysis by opposing counsel in argument before the Court of King's Bench in the case of Bowman v. Taylor.<sup>8</sup> Hayne v. Maltby and Taylor v. Hare were both discussed and it was argued by the plaintiff that with landlord and tenant an eviction had to take place and accordingly with a licensee of a patent it would be necessary for there to be the equivalent of eviction, either by recall of the patent or by its open invasion and that this would have to be pleaded for a licensee to have a defence to action by a licensor for royalties. Only one

<sup>8</sup>(1834) 2A.C. 6E. 279; 111 E.R. 108.

judge, Patterson J. mentions eviction<sup>9</sup> and he does so in passing in that he regarded it as unnecessary to comment on it in the light of his conclusion resting on another ground. The general question of consideration, from which eviction may be seen as flowing, is not mentioned in any of the judgments.

The noteworthy aspect of Bowman v. Taylor is that it is the first case where it was held that estoppel could operate to prevent a licensee from challenging the validity of a patent. The indenture entered by the defendant had commenced by reciting that the plaintiff had invented certain improvements in the construction of looms for weaving and that he had obtained His Majesty's letters patent containing a grant to the plaintiff, his executors, etc. for his sole use of the patent. It was argued by counsel for the defendant that the general approach to estoppels was that stated by Lord Coke and that they were "odious, and not to be construed or raised by implication" and that among the rules laid down in Co. Lit. 352(b) are these:

"Secondly, that every estoppel, because it concludeth a man to allege the truth, must be certain to every intent, and not to be taken by argument or inference. Thirdly, every estoppel ought to be a precise affirmation of that which maketh the estoppel, and not to be spoken impersonally"  
- "Neither doth a recital conclude, because it is no direct affirmation."

Counsel in applying these statements, argued that the indenture had stated that "whereas" the plaintiff had invented certain improvements and therefore this was an impersonal statement and a mere recital and would not be accepted by Lord Coke. Further, the statement that the

<sup>9</sup> Ibid. p. 294.

plaintiff had "invented" was not sufficiently certain to meet the defendant's pleas that the matter covered in the patent was not a new invention and that the plaintiff was not the first or true inventor. The argument was made that "invented" could cover something that had been invented fifty years ago and been subject to prior public use and should this be the case, the defendant could not be estopped from making his pleas.

The court rejected the above arguments and held that estoppel applied. Lord Denman C.J. and Patterson J. took cognizance of Lord Coke's statement but held that a recital in a deed could act as an estoppel: Lord Denman did so on the authority of Lainson, Executor of Griffiths v. Tremere<sup>10</sup> where the annual rent for a lease was said to be part of a recital; Patterson J. considered that if a recital was inseparably mixed with the operative parts of a deed, as he regarded it as being in this instant, then it could estop denial.

Taunton, Patterson and Williams J.J. all considered that the statement that the plaintiff had invented the improvements indicated with sufficient certainty that the invention was new and that the plaintiff was the first or true inventor. Hayne v. Maltby had been strongly argued by the defendant but this case was distinguished on the ground that in that case, the recital had contained no assertion of right in the licensor other than being assignee of the patent.

The way in which Hayne v. Maltby is distinguished is an example of distinguishing on the facts with virtually no regard

<sup>10</sup> (1834) 1 A. & E. 792; 3N. & M. 603.



given for the theme of the judgments. Estoppel was rejected in that case without any indication of the rejection turning on fine points of construction. Perhaps what this does do is indicate that if indeed Bowman v. Taylor was good law when the decision was delivered it stands only for the proposition that estoppel only arises on matters stated in the licensing agreement. Therefore, on a strict following of the decision if the pleas had challenged the validity of the patent on other grounds, then such pleas would have to be entertained. That is, the decision cannot be regarded as authority for the proposition that a licensee may not challenge the validity of a patent in any way.

An emphatic return to the theme of Hayne v. Maltby is to be found in the case of Chanter v. Leese<sup>11</sup>, a case which later authorities appear to overlook. In this case, the plaintiff and others entered an agreement, not under seal, with the defendant in which it was recited that the plaintiff had obtained a patent for an improvement in furnaces and alone and with the others had obtained patents in a total of five other related patents; it was agreed that for the payment of Four Hundred Pounds a year as consideration to the plaintiff and various other percentages of profits on matters covered in other patents to the others, the defendant was to have the exclusive use of the patents within certain limits. Later the plaintiff brought an action against the defendant for payment of the half yearly amount of the Four Hundred Pounds. To this the defendant set out the patent for the improvement in furnances and pleaded that it was not at the time of the grant a new invention as to the public use thereof in England and therefore the grant was void.

<sup>11</sup>(1839) 5 M. & W. 698; 151 E.R. 296.

On the plaintiff demurring to this plea the case was heard by the Court of Exchequer,<sup>12</sup> and upon Lord Abinger C.B., on behalf of the court, finding in favour of the defendant the plaintiff was taken by writ of error in the Exchequer Chamber. Tindal C.J. on behalf of that court, affirmed the decision of the Court of Exchequer.

On the vital question of consideration, Lord Abinger C.B. and Tindal C.J. expressed themselves in similar terms. Tindal C.J. stated<sup>13</sup> that as the matter rested on contract and no interest had passed to the defendants, the defendant was in no way estopped from showing any failure of the consideration for his promise to pay the annuity to the plaintiff which may be sufficient to bar the plaintiff of his action. The plaintiff had argued that even if one patent was void there was still consideration provided by the defendant's enjoyment of the other five patents to which no challenge had been made. On this basis, it was contended that the defendant was bound to pay the annuity and bring a cross action for damages in respect of the one void patent. This argument was also rejected in both courts in the light of there being no indication in the agreement that the consideration had been divisible with apportionment accordingly being available. As the consideration under the agreement was entire, a failure of consideration for one patent was a partial failure that led to entire failure.

No doubt it was in accord with the laissez-faire notions that became the convention of the 19th Century with the resulting strong support given by the courts to upholding all contracts that gave rise to the next phase of development in the patent licensing and

<sup>12</sup> (1838) 4 M. & W. 295; 150 E.R. 1440

<sup>13</sup> 5 M. & W. 698; 700.

assigning field. The decisions in which pleas of invalidity had been upheld began to fade with only the occasional lip service being given to their existence. The limited basis on which pleas of invalidity had been denied in earlier cases were virtually disregarded as rejection of these pleas became almost automatic.

Three distinct, albeit related, grounds for rejecting pleas of invalidity began to gain coherence: First, any recital in a deed that related to patent rights tended to be construed as a recital whereby full patent validity had been accepted and hence denial of validity on any ground was said to be estopped; secondly, in any licensing arrangement, whether it be by deed or ordinary agreement, was viewed as being exempt from attack on the basis of failure of consideration if it was not also shown that the licensee had been "expelled" i.e. actual expulsion from operating in the field was required and a mere demonstration that others were also exploiting the field did not suffice; thirdly, in a disguised form of the consideration argument, popularity was gained for construing licensing and assignment agreements so as to exclude any construction of the agreement that would make it an implied term that the patent was valid. The emergence of these approaches will now be discussed in greater detail.

The case of Cutler v. Bower<sup>14</sup> involved two deeds. By the first deed the defendant was granted an exclusive license to make use of a patent that embraced the construction of tubular flues of steam boilers with a covenant by the defendant to pay a set royalty for

<sup>14</sup> (1848) 11 Q.B. 973; 116 E.R. 736.



every ton of flues manufactured. In the later deed there was a recital of the first deed followed by a covenant by the defendant to pay Two Thousand Two Hundred Pounds (by installments) for the assignment to him (through a trustee) of half the patent rights with half of the royalty payments due under the first deed to go with the assignment. The plaintiff brought action for failure to pay the royalties under the first deed and failure to make the installment payments under the second deed. The pleas by the defendant were based on invalidity of the patent.

Lord Denman C.J. in delivering the judgment of the Court of Queen's Bench made light of the distinction that the defendant attempted to draw between this case and that of Bowman v. Taylor. It was argued that in this case no specific mention was made in the deeds between the parties as to the plaintiff being the inventor of the invention covered by the patent. Further, even if estoppel did apply to pleading that the invention was not new and the plaintiff was not the first inventor the defendant should not be estopped from denying that the specification did not support the patent (i.e. the invention was not fully described). Lord Denman said that it was not necessary to decide this point because the court was of the view that the judgment must be for the plaintiff on other grounds.

The other grounds then selected by Lord Denman have a curious similarity to the ground on which decision was deemed unnecessary. He held that the defendant was bound to pay the royalty payments stated in the first deed because there had been no eviction and hence no total failure of consideration and the royalty was due "whether the patent was

valid or not, as (the defendant) would be estopped in an action upon that deed from denying the validity of the patent".<sup>15</sup> With respect to the payment of the money for purchase of the half share in the patent, as covenanted in the second deed, it was held that this was to be regarded as a "mere covenant in gross for the payment of money" which was wholly independent of any covenant that may be made by the plaintiff.

Lord Denman concluded his judgment by mentioning with respect to the assignment that "each party may recover against the other for a breach of their respective covenants."<sup>16</sup> Nonetheless for this particular action he concluded that the invalidity of the patent, as stated in the pleas, afforded no ground of defence at law for the covenant in question. How much this case rests on the intricacies of pleading is not known. Possibly the defendant could have brought a successful action against the plaintiff for the breach of one of the clauses present in the second deed whereby the plaintiff covenanted the validity of the patent. The way this covenant may have affected matters is not known as this aspect of the case does not appear to have been remembered.

Laves v. Purser,<sup>17</sup> another case decided in the Court of Queen's Bench, provides a slight extension of Taylor v. Hare. In Taylor v. Hare, the plaintiff was the licensee who was seeking recovery of royalties previously paid on what was discovered to be an invalid patent. By contrast, Laves v. Purser had the more familiar action by a patentee for royalty payments of 10 shillings per ton that were said to be due under a license for manufacturing manure. The defendant's plea

<sup>15</sup> Ibid. p. 986.

<sup>16</sup> Ibid. p. 986.

<sup>17</sup> (1856) 6 E.L. & B.L. 930; 119 E.R. 1110.

that the patent was invalid was held to be bad on the grounds that the defendant had operated under the license and therefore, there was no failure of consideration. As in Taylor v. Hare, the argument by the licensee that everyone was free to use the subject matter of an invalid patent was not taken up by the court but instead it was suggested that the absence of any allegation of eviction of the licensee made the plea of invalidity bad.

There is a comment by one of the judges in Lawes v. Purser that would appear to put a halt to a full extension of Taylor v. Hare. Erle J. suggests<sup>18</sup> that licensees who came to the view that a patent was invalid should give notice to the patentee that the validity of the patent was disputed and henceforth they would use the invention in their own right and not under the permission of the patentee. He thinks that "perhaps" on any action on the agreement for subsequent use the invalidity of the patent might be a defence.

A final comment on Lawes v. Purser relates to the interpretation placed on earlier cases: Bowman v. Taylor was cited in favour of the plaintiff's case, but Wightman J. interjected to state that that case turned entirely on estoppel by the deed (a deed was not used in Lawes v. Purser); Hayne v. Maltby was represented as a case turning on fraud and also turning on the point which was alleged to be the basis of Chanter v. Leese viz. a mere executory contract. This categorisation of the contracts in the earlier cases being merely executory is a misleading exercise in semantics. Hayne v. Maltby makes no specific mention of this factor. In Chanter v. Leese, there is a

<sup>18</sup> Ibid. p.936



passing reference to it but only to contrast the agreement with one in which there is an outright assignment. The nature of the agreement in Lawes v. Purser does not seem any less an executory contract than in the earlier cases. The "executory" categorisation could be given to the Lawes v. Purser agreement as well, if the court took the same approach as in Chanter v. Leese and considered it to be necessary for the licensor to provide a valid patent before any obligation fell on the licensee to carry out his covenant.

In a significant case involving the assignment of patent rights a different tack is taken in Hall v. Condor.<sup>19</sup> Rather than being concerned with estoppel or with a direct analysis of consideration, the Court of Common Pleas analysed the agreement under which assignment of a patent took place and concluded that there was no implied warranty that the patent was valid. The assignment was for half of the interest in an English patent related to the prevention of boiler explosions. The patentee had already assigned away the other half to another party. The agreement was expressed in a memorandum of agreement that was couched in quite informal terms and much of the argument in the case centred on the issue of whether the Two Thousand, Five Hundred Pounds sum mentioned in the memorandum was due or whether appropriate part payment had already been made. The defendant assignee was unsuccessful in his pleas relating to payment and accordingly much of the argument was on the defendant's plea relating to the alleged invalidity of the patent.

<sup>19</sup> (1857) 2 C.B. (N.S.) 22; 140 E.R. 318

Williams J.<sup>20</sup>, in delivering the judgment of the court, reviewed cases involving the sale of chattels. He concluded that the law relating to the sale of ascertained chattels was that there was no implied warranty of either title or quality unless there were circumstances beyond the mere fact of a sale from which it may be implied. By analogy the contract for the sale of a moiety of patent, being an ascertained thing could have no implied warranty unless some other factor was present. An analysis of the relative knowledge of the parties was made: Whether the invention was worthless and of no utility to the public, this was as much with the knowledge of the defendants as the plaintiff and therefore, no warranty could be implied; on whether the invention was new and whether the plaintiff was the first and true inventor the same conclusion was reached! Accordingly, as no warranty could be implied, the basis of the contract was merely to place the defendants in the same position as the plaintiff with reference to the patent.

Only one earlier case related directly to patents was mentioned in argument and in the court's decision, that of Chanter v. Leese.<sup>21</sup> It was distinguished on the ground that the plaintiff in that case had contracted that the defendants should have the exclusive rights under the patent and hence "there was no doubt as to what the parties contracted for". Williams J. makes no analysis of the decision itself in Chanter v. Leese - the exclusive nature of the license receives no direct attention in that case - nor does he canvass the possible result

<sup>20</sup>Ibid. pp. 40-42.

<sup>21</sup>Supra note 11.

in the instant case if there had been an assignment of all the interest in the patent and not just half the interest.

The defendants in Hall v. Condor took the case on error to the Exchequer Chamber but the judgment of the Court of Common Pleas was affirmed without further reasons being stated.<sup>22</sup>

The hearing of the case of Smith v. Neale<sup>23</sup> had commenced in the Court of Common Pleas before the hearing of Hall v. Condor with the decision being given after it. In that case, there was also a plea by the defendant that the patent was invalid and in fact it was also pleaded that the patent had lapsed through failure to lodge a specification in support. The agreement, that was merely in the form of a memorandum signed by the defendant and orally assented to by the plaintiff, conveyed the patent to the defendant with an option for the plaintiff to reclaim it if royalty payments fell below a certain level. Without analysis of possible differences arising through these circumstances Willes J. cited Hall v. Condor and stated that the only warranty implied in the contract was that a patent grant had been made. Willes J. concluded:

"In short, the defendant in this case, as in Hall v. Condor, contracted for the use of the plaintiff's right such as it was, without regard to whether it could be sustained upon litigation or not: and there is nothing unreasonable or uncommon in such a bargain."<sup>24</sup>

<sup>22</sup> Supra note 19, p.55

<sup>23</sup> (1857) 2 C.B. (N.S.) 67; 140 E.R. 337

<sup>24</sup> Ibid. p.89



In the development of the law sketched so far, different grounds for rejecting pleas of patent invalidity are seen. Each one of these grounds seems to have had limitations placed on it. A case in which lawyers for the defendant appear to have taken the best of precautions in avoiding the stumbling blocks presented by earlier cases to successfully pleading invalidity is that of Smith v. Scott.<sup>25</sup> This case cannot be regarded as a landmark decision in itself because it stopped at the level of the Court of Common Pleas and in the years to follow the decisions of higher authorities tended to put it in the shadow. Where it is of main interest is that it disregarded the reasoning that supported earlier decisions and emerged as a warning to anyone whose faith in stare decisis may be coming a little intense. It certainly appeared to put defence counsel in a very defensive mood indeed in later cases where patent invalidity was sought to be pleaded.

In Smith v. Scott the plaintiff, who had obtained a patent for his invention to do with improvements in the manufacture of wire rope, had entered a deed whereby the defendant was granted an exclusive license to work the patent. When the plaintiff brought action for recovery of royalty payments that the defendant had covenanted to pay on each ton of wire produced, the defendant made various pleas, two of which were demurred to by the plaintiff and were put to the court.

Under one plea the defendant stated that the plaintiff did not give and the defendant did not take the exclusive license provided for in the deed. The other plea was in similar terms

<sup>25</sup> (1859) 6 C.B. (N.S.) 773; 141 E.R. 654

to that of Hall v. Condor - that the invention was worthless, of no utility, not new and that the plaintiff was not the true and first inventor - but added to the Hall v. Condor form of words "that the plaintiff knew (of this) and the defendant did not and had no notice or knowledge thereof."

The way in which these pleadings were drawn would seem to be no accident and the resume given in the report of the argument of counsel for the defendant indicates that adoption had been made to favourable authority and unfavourable authority was being avoided. However, this was unsuccessful. The judgments of Williams J. and Willes J. effectively overlap with that of Byles J. adding nothing of substance. The following is noted on their treatment of earlier authorities:

- (1) Hall v. Condor and Smith v. Neale were accepted as being authority for rejecting the second plea without any note being taken that Hall v. Condor had been based on a lack of implied warranty that the patent was valid; in that case, it will be recalled, the lack of superior knowledge available to the plaintiff was invoked as a test that indicated no implied warranty of validity yet in the instant case, that superior knowledge is pleaded.
- (11) Laves v. Purser is also taken as authority for rejecting the second plea without any regard for the fact that in that case "enjoyment" of the license was the material aspect that led to rejection of the plea, yet

in the instant case, it was specifically pleaded in the first plea that the defendant did not take or have the license.

(iii) Chanter v. Leese is noted as a case in which the plea of invalidity of a patent was accepted with respect to an exclusive licence on the grounds of complete failure of consideration, but was distinguished on the ground that failure of consideration did not apply in the instant case because the agreement was in the form of a deed.

(iv) Hayne v. Maltby is noted but only in passing in that the part of the judgment of Taylor J. in Bowman v. Taylor where Hayne v. Maltby was distinguished is highlighted. This is the passage in which Taylor J. pointed to the estoppel that arose due to the plaintiff in that case being described in the recital to the deed as having "invented" the invention and contrasting it with Hayne v. Maltby where the plaintiff was described only as the assignee. This portrayal of Bowman v. Taylor is not continued, however, because there is no mention of any recital in the deed of the instant case that may infer validity of the patent.

What emerges from Smith v. Scott through its jumbling of authorities seems to be an inflexible rule that when the licensing of a patent occurs by deed there will be no opening for



the licensee to challenge validity, with the possible proviso left by this and earlier cases that proof of fraud may give grounds for challenge. The earlier authorities show an adaption of broader principles derived from the general field of law, but this case lends the rule an autonomy from the general field.

Noton v. Brooks<sup>26</sup>, a case of a license granted under ordinary agreement, did not share the subtle drafting of pleadings used in Smith v. Scott, and seemingly due to the absence of anything implying validity in the agreement Hall v. Condor was applied by the Court of Exchequer without comment.

Emergence of what may at first seem to be nearly an absolute rule of estoppel against challenge by a licensee of the validity of a patent is to be found in Crossley v. Dixon<sup>27</sup> a decision of the House of Lords. In this case there was no chance of resting the decision on the impact of a deed because the licensing agreement was entered verbally and its nature was so vague that the defendant even denied that the agreement amounted to a license. It was alleged by the appellants that they had verbally agreed to grant a license to the respondent to use carpet looms that were covered by a number of patents that had been acquired from various sources. The respondent was to be free to acquire the looms from any source provided he paid a stipulated royalty. In the event, the respondent made an outright purchase of forty-one looms from the appellants and paid royalties on their use. The respondent later purchased twenty-three looms from a third party. The appellants alleged that these

<sup>26</sup> (1861) 7 H. & N. 499; 158 E.R. 569

<sup>27</sup> (1863) 10 H.L.C. 294; 11 E.R. 1039

looms were an infringement of the appellants' patents. An order was made in favour of the appellants by the Vice Chancellor which, on appeal, was varied by the Lord Justices and it was on the variation that the appellants took the case to the House of Lords. In effect the issue to be resolved was whether action under the alleged license was appropriate or whether only infringement proceedings were available. This was necessary because the defendant-respondent had denied he was a licensee, questioned the validity of the patents and also asserted that the looms that he had acquired elsewhere did not fall within the scope of the patents.

Many of the cases that have already been discussed are mentioned in argument by counsel but their Lordships' judgments are noteworthy through the absence of any cited cases. The Lord Chancellor, Lord Westbury, asserts<sup>28</sup>

"...the first contention on the part of the Respondent is this, that notwithstanding that relation (of licensee) continues, he is at liberty to deny the title of the Appellants to the ownership of the inventions, for the use of which he is thus paying a royalty. We are all very well aware that that is a proposition inconsistent with law, as it would be equally inconsistent with the ordinary reason and good sense of mankind".

The only further comment on this aspect of the case is made by Lord Chelmsford who stated that there can be no refusal by the defendants to pay the royalties because "He cannot act under the

<sup>28</sup> Ibid. p. 304.

agreement, and, at the same time, repudiate it". It was the continued payment of royalties on the looms purchased from the plaintiffs that Lord Chelmsford regarded as clearly establishing that a patent licensing relationship existed,<sup>29</sup> but details of the nature of that relationship were regarded as having no impact because he says:

"It is unnecessary to consider very closely what was the exact character of the agreement between the parties".

On issues relating more to fact than law, the conclusions reached by the House of Lords were that a licensing arrangement existed and that there had been sufficient evidence presented to the Vice-Chancellor for there to be a finding that the looms acquired from the third party fell within the scope of the patents. As, on a question of law, the validity of the patents could not be denied by the defendant royalty payments were due on the looms. It was at this point, however, that the House of Lords made a most significant variation to the order made by the Vice-Chancellor. The Vice-Chancellor had declared that the defendant was not entitled to use any machines constructed in accordance with the plaintiff's invention without paying the royalty. Their Lordships modified this declaration of non-entitlement by ordering that the defendant was not entitled to use the machines "during the continuance of the agreement between the Defendant and the Plaintiffs".

<sup>29</sup> (1852) 15 & 16 Vict. c.83, s.35 which deems the patentee to be the exclusive proprietor of all interests, licenses and privileges unless an assignment or license is recorded in the patent Register was overlooked by all as it is clear no registration was made.



The reason for this modification of the order is that the defendant was said to be prevented from denying the validity of the patents only whilst he was operating under the agreement. The Lord Chancellor says that

"(The) license being the foundation of the claim, and of course determinable by the Respondent at pleasure, if he chose to put an end to that license, it follows that the present Appellants, if he continues to use the machines must treat him only as a person infringing their patent right." <sup>30</sup>

And, similarly, Lord Chelmsford said

"He may, if he pleases, put an end to the agreement, and he may use the machines which he has purchased from the Plaintiffs; but he must do so at his peril; he must do so under the liability to be treated as an infringer, and to be subject to an action for damages for that infringement." <sup>31</sup>

This puts matters in a different light to estoppel by deed. Under Bowman v. Taylor <sup>32</sup>, where the recital in the deed was held to estop denial that the patentee had invented the subject matter of the patent, that estoppel would appear to still apply even if the licensee purported to terminate the agreement and face the patentee as an alleged infringer. The case of Carpenter v. Buller <sup>33</sup> that has been mentioned in some of the patent cases would not have assisted in those times, at least.

<sup>30</sup> Ibid. p.308.

<sup>31</sup> Ibid. p.310.

<sup>32</sup> Supra note 8.

<sup>33</sup> (1841) 8 M. & W. 209; 151 E.R. 1013

In Carpenter v. Buller a recital in a deed which indicated the boundary of the defendant's land was held not to estop the defendant from claiming otherwise in a later action that was based on matters quite distinct from that encompassed by the deed. It would seem that a licensee would not be able to bring himself within the Carpenter v. Buller situation by changing status from licensee to alleged infringer because the situations would be sufficiently interrelated for any estoppel to still apply.

The accent that the House of Lords in Crossley v. Dixon put on the ability of the defendant to terminate the license if he wished to make a proper challenge of the validity of the patents should be regarded as placing a limit on the broader statements used in the judgment. The case concerned a verbal license that could be terminated at will. Would the members of the House of Lords have so readily grasped their decision if the agreement was for a license over a set number of years, especially if there were many years to run? Can the decision be said to embrace assignments?

Take the following fact situation that would be far from typical: a licensing arrangement is entered by a memorandum of agreement with the term to be the unexpired portion of the patent. Suppose that the licensee paid the royalties but then disputes arise between the licensee and licensor; assume the licensee terminates the agreement say 10 years before its expiry date and continues to carry out the patent process outside the license agreement. If the patentee was then to bring an infringement action which was defeated by a successful challenge to the validity of the patent, what answer would be given if the patentee then brought

action for damages for early termination of the licensing agreement? The suggestion made in Crossley v. Dixon that the licensee should terminate the licensing agreement if the patent is to be challenged would have been followed. The facts would be on all fours with the original case in the area, Hayne v. Maltby, and there is nothing stated in Crossley v. Dixon that would prohibit the result of that case being followed. Accordingly, whilst real difficulties may confront a defendant in resisting an action on the license because of the impact of statements made in cases following Hayne v. Maltby there is no direct bar to a successful defense of such a case to be found in the House of Lords consideration of Crossley v. Dixon.

Before leaving the hypothetical situation presented above, a further reason for giving the Crossley v. Dixon decision a limited ambit can be seen if the facts are altered. Suppose the licensee does as before and purports to terminate the agreement. He continues using the process and awaits the infringement action. Under Section 42 of the Act <sup>34</sup> then in force any of the superior courts could hear the infringement action and if infringement is found, an order could be made granting an injunction, inspection or account (similar powers exist under modern legislation). If the challenge on validity was unsuccessful and infringement found an injunction may then be ordered. Suppose that an avaricious patentee

<sup>34</sup> (1852) 15 & 16 Vict. c.83.



then follows this by an action for damages for termination of the agreement. Could he recover for the ten years license payments if, for simplicity sake, the payments were stated on a time basis? A clear "no" would seem the only reasonable response, but should that be the response, there could seem to be no justification for the alternative: an award of license payments following a declaration of invalidity.

It is also to be noted that the rationale of Crossley v. Dixon - a licensee should not be able to enjoy an agreement and at the same time challenge it - cannot be applied to assignment agreements. The differences between an exclusive license and an assignment often would be of little practical impact to the parties because there are many devices available whereby the amount due on assignment could be paid off over a period with the rate of payments being fixed on a royalty basis calculated on the goods produced. In fact, in some of the earlier cases, it is difficult to determine whether it was an exclusive license or an assignment that was being made. All sorts of parallels with other areas of law could be drawn, however, to infer that there may be different legal results on a patent license - even one running for the term of the patent - and a patent assignment. Reflections on the dicta in Crossley v. Dixon that related to the case in which the defendant could terminate the agreement and then challenge the patent implies that an assignment may have been treated differently by the House of Lords. However, courts in later cases have shown no

concern for this possible difference and licenses and assignments have not been distinguished from the point of view of challenging validity.

The House of Lords had a further opportunity to consider the question of licensee estoppel in the case of Clark v. Adie (No.2.).<sup>35</sup> The licensee did not attempt to challenge the validity of the patent but limited his defense to arguing that in the light of the prior art the patent should not be construed to embrace his activities. That is, he was arguing that royalties were not due because his goods were not within the patent. Further aspects of this case will be discussed at a later stage. For the moment, its significance is that there are remarks made in the course of the judgments that clearly assert that a licensee may not challenge the validity of a patent. No cases are cited, but Lord Blackburn states:

"The position of a licensee who under a license is working a patent right, for which another has got a patent, is very analogous indeed to the position of a tenant of lands who has taken a lease of those lands from another. So long as the lease remains in force, and the tenant has not been evicted from the land, he is estopped from denying that his lessor had a title to that land."<sup>36</sup>

This statement has a breadth of scope that conceals the origins of licensee estoppel.

<sup>35</sup> (1877) 2 A.C. 423.

<sup>36</sup> Ibid. p. 435.

### 3. A Frequent Result becomes the Absolute Rule.

As has been outlined, a prohibition on a licensee or assignee of a patent making a challenge to the patent's validity first emerged as the result of construing the agreement. Recitals in a deed were held to estop, absence of express covenants was found to give rise to no implied warranty on validity and with a selection of analogies that often centred on landlord and tenant or sale of chattels the result was becoming predictable. The statements made by the House of Lords in Crossley v. Dixon and Clark v. Adie were couched in language that did not appear to allow variation from the normal result and hence "estoppel" became an absolute rule noted without qualification by the textbooks of the time.

That memory of the origins of the rule became forgotten is illustrated by the cases now to be noted. It would seem that application of the original more traditionally-orientated methods of construction would have led to different results in these cases, but this was prevented by the absolute estoppel rule that now had a life of its own.

In Mills v. Carson,<sup>37</sup> a case going to the level of the Court of Appeal, action was brought against licensees who refused to make the semi-annual royalty payment after the patent had lapsed through non payment of fees and failure by the patentee's assignee to carry out his covenant to bring action against infringers. A plea that the patent was ineffectual through lack of novelty was also made.

<sup>37</sup> (1893) 10 R.P.C. 9



The indenture setting up the license was detailed and appeared to put the defendant in a favourable position. First, the period of the exclusive license was "for the remainder of the term of years for which the patent had been granted." Despite the argument that the Patent Act itself stated that the term of the patent ceases if the required fees are not paid, all the members of the court concluded that the phrase should be construed as meaning fourteen years, that is, the normal term of a patent. Secondly, the indenture stated that

"...if the (patentee) should at any time omit to take (any necessary infringement) proceedings, and if the said Letters Patent should become void or ineffectual by reason of any such omission or refusal on the part of the said (patentee), or by reason of the said invention not being novel or being an infringement of other Letters Patent, then the payment of the said annual sum under the Indenture should cease and determine..."

In construing this clause, Lord Esher,<sup>38</sup> Lopes L.J.<sup>39</sup> and Kay L.J.<sup>40</sup> all adopted the same approach, saying that the relationship of patentee and licensee estopped the defendant from denying the validity of the patent and accordingly, the defendant was not permitted to show that the invention was not novel. Further, on the infringement aspect, it was only if invalidity had been declared through an infringement action that

<sup>38</sup> Ibid. p.17

<sup>39</sup> Ibid. p.19

<sup>40</sup> Ibid. p.21

the payment should cease. (Needless to say, this had not occurred because no action had been taken against infringers!)

There was a further clause of the indenture that was subject to argument, a clause in which the patentee covenanted the quiet enjoyment of the license. It was accepted by the court that the lapse of the patent may have breached this covenant but, on construction, the argument that this went to the whole consideration was rejected. It was held that this was an independent covenant that could possibly have given rise to a counterclaim but, as no counterclaim had been brought, the licensee remained obligated to pay royalties for the residue of the fourteen years.

Given the approach adopted by the Court of Appeal it would seem difficult for a clause to be drafted that would allow a licensee to escape liability for royalties in the event of the patent collapsing. However, results remained a little unpredictable in that a different attitude prevailed in Cummings v. Stewart<sup>41</sup> where an exclusive license was granted for patents taken out on an invention in England, France and Austria and the French and Austrian patents lapsed due to renewal fees being unpaid. A clause in the license agreement whereby the patentee covenanted to take action against infringers was the main clause relied on by O'Connor M.R. in determining that there was an implied obligation on the patentee to keep the patents

<sup>41</sup> (1913) 30 R.P.C. 1

alive by paying renewal fees. Mills v. Carson was reviewed in the decision but the Master of the Rolls was of the view that it was a matter of construction with each agreement and the agreement under examination favoured a result contrary to that reached in Mills v. Carson. The further conclusion reached was that the obligation to pay fees could not be regarded as an independent covenant but went to the real consideration for the licensee's covenant to pay. Harking back to the much-overlooked Chanter v. Lees,<sup>42</sup> O'Connor M.R. concluded that the rights in the three countries could not be regarded as divisible and that lapse of the patents in two countries constituted a failure of consideration for a major part which led to an overall failure of consideration.

On the issue of the patent becoming void through non payment of fees to the Patent Office, Mills v. Carson rather than Cummings v. Stewart was followed in the Canadian case of Bull v. Williams Piano Co. Ltd.<sup>43</sup> The case is in the note form only but it would appear the Cummings v. Stewart was not even considered.

The lapsing of the patent would seem to fall within the category of "eviction" which is mentioned by Lord Blackburn in Clark v. Adie (No. 2)<sup>44</sup> Invalidity of a patent being declared through its lack of novelty would also seem to constitute "eviction" within these terms and this possible form of argument

<sup>42</sup>Supra note 11

<sup>43</sup>(1925) 29 O.W.N. 304

<sup>44</sup>Supra note 35



was heeded by defence counsel in the case of The African Gold Recovery Company Ltd. v. The Sheba Gold Mining Company Ltd.<sup>45</sup>

Also taken up in this case was the hint provided by the dicta in Crossley v. Dixon<sup>46</sup> in that the defendant immediately advised the plaintiff that he was terminating the agreement when the patents were declared invalid. In this case, a four year license had been granted with the defendant covenanting to pay 5 per cent on all bullion produced by the patented processes and also covenanted to purchase all its cyanide requirements for operating the process from the plaintiff. Shortly after entering the agreement all patents were declared invalid through the action of a third party. The defendants gave immediate notice of terminating the agreement. Upon the plaintiff commencing action under the agreement, the defendant pleaded that validity of the patents had been an implied condition of the agreement and in the light of the challenge by the third party being known when the licensing agreement was entered, the implied condition was backed by an express statement by the plaintiff company's secretary that the agreement would be rendered void if the patents were invalidated. It was also pleaded that the cancellation of the patents amounted to an eviction.

All the pleas were rejected by Matthew J. with

<sup>45</sup>(1897) 16 R.P.C. 660

<sup>46</sup>Supra note 27

his citing of the "general rule" that a licensee cannot dispute validity. On the eviction argument, Matthew J. noted that the defendant had, and still could, enjoy the benefit of the agreement. Accordingly, the order made was for payment of past royalties, an accounting for the remainder of the four years and loss of profits on the cyanide which the defendant had ceased buying from the plaintiff.

There was early acceptance of an unequivocal estoppel rule in Canada where pleas seeking to challenge validity were summarily rejected in Gray v. Billington<sup>47</sup> and Vermilyen v. Canniff.<sup>48</sup> In those cases "eviction" could not have been argued, however, the lack of success of such an argument was illustrated in the case of Anderson v. E.J. Shepard Ltd.<sup>49</sup> In this case, the defendant had been granted an exclusive license and made the main base of his defence to an action for non payment of royalties an argument that the patentee had failed to take action against infringers of the patent. There was a clause of the licensing agreement that provided that the licensee would not challenge the validity of the patent and clearly this clause in combination with the general rule must have dissuaded the defendant from making a direct attack of validity an aspect of his defence. The Ontario Court of Appeal rejected the defence and the related counterclaim for failure to enforce the patent on the

<sup>47</sup> (1871) 21 U.C.C.P. 288

<sup>48</sup> (1886) 12 O.R. 164

<sup>49</sup> (1930) 66 O.L.R. 105; [1931] 1 D.L.R. 204 (C.A.)

ground that there was no specific undertaking to be found in the agreement for the patentee to act against infringers. This result was reached by the court canvassing the general rules that it considered to be applicable and concluding that in the absence of fraud or misrepresentation no defences were available to an action for royalties, because caveat emptor applied.

A different attitude is to be found in the Ontario Court of Appeal a little over a decade later in the case of Trubenizing Process Corp. v. John Forsyth Ltd.<sup>50</sup> A key clause of the agreement for the non-exclusive license in this case stated

The Licensee admits the validity of the patents referred to herein and agrees not to contest the validity of any of the aforesaid patents and agrees not to become voluntarily a party directly or indirectly to any procedure disputing the validity or tending to impair the value of any of the said inventions or Letters Patent covering the same, during the period of this license and at all times thereafter except as to such patent or patents as may be adjudicated invalid by a court of competent jurisdiction from whose decision no appeal is or can be taken."

Two patents were covered by the license.

A third party had challenged the validity of these patents and one had been declared invalid by the Exchequer Court and the second upheld by that court. The patentee took no appeal on the

<sup>50</sup> [1942] O.R. 271 (C.A.)



first patent but the challenger took an appeal on the second and that patent had been held invalid by the Supreme Court. The patentee appealed to the Privy Council, at the same time lodging with the Patent Office a disclaimer that limited the scope of the patent. The Privy Council did not pass judgment on the validity of the patent as so limited, but restricted itself to declaring that the patent as originally filed was invalid.

The plaintiff brought action for recovery of royalties that the defendant had ceased paying after invalidity had been declared. At trial, Chevrier J. accepted the defendant's argument that with one patent being invalid and the other, now with disclaimer, being something other than what was originally contracted for the defendant was relieved from the obligation to pay royalties. The second point aside, Chevrier J. was of the view that the disclaimer did not meet the requirements of Section 50 <sup>50a</sup> of the Patent Act and accordingly, it had to be adjudged invalid also.

In the Court of Appeal, Robertson C.J.O. was of the view that the invalidity of one patent and the modification of the other did not necessarily permit the non payment of royalties but he nonetheless found for the defendant on the ground that action was being taken by the assignee of the patentee and there had not been complete assignment of the benefit

<sup>50a</sup> Under S.50 a disclaimer may be made to remedy a defect resulting from an error arising from "inadvertence, accident or mistake".

of the license to the assignee due to only the valid patent being named in the assignment. Henderson J.A. and Gillanders J.A., in separate judgments, made a more fundamental attack on the plaintiff's claim, being of the view that no royalties could be due once the entire foundation of the agreement had disappeared.

On appeal to the Supreme Court the decision of the Ontario Court of Appeal was reversed. With Rinfret J. dissenting and the rest of the court concurring in the judgment delivered by Davis J. the licensee's covenant to pay the royalties was held to be an independent covenant that remained operative and effective notwithstanding the adjudications that have been made with respect to the two patents named. The clause that is quoted above was noted as causing some difficulty but no explanation is given as to its proper construction. Davis J. said that there was another clause that should not be overlooked, this being a clause whereby the patentee covenanted not to sue the licensee for any infringement of any patent "now owned or controlled or hereinafter acquired or controlled by (the patentee)." No remark was made on the quid pro quo indicated in the immediately following clause of the agreement whereby the licensee covenanted to patent any improvements that it may discover and assign them to the patentee. It would seem that even a clause stating that royalties need only be paid whilst a patent subsists is not sufficient to remove liability even when it expires.

Given the tendency of the courts to place such heavy weight on the estoppel rule that implied covenants of validity can seldom emerge the question arises as to whether an express covenant of validity will protect a licensee. In Henderson v. Shiels<sup>51</sup> an express covenant of validity was held to go to the very basis of the agreement but the agreement was only to procure a license and the license had never been executed, but given the dicta that estoppel may have arisen if the grant had actually taken place, one is left in doubt on the effectiveness of such a clause. In Gillard v. Watson,<sup>52</sup> a case heard by the Appellate Division of the Supreme Court of Ontario, there was a completed license under seal which contained a covenant of validity of the patent. Despite this, the court held that the covenant had become a warranty as the license had been granted and acted on. It being only a breach of warranty it could not be a full defence and in the absence of a counterclaim being set up, evidence of invalidity was not admissible.

This appears to vary so drastically from the traditional approach to contracts of a continuing nature that it would seem to be just a different way of expressing a near-absolute estoppel rule.

An interesting, perhaps bewildering, extension of the estoppel theme is to be found in Coyle v. Sproule.<sup>53</sup> In this

<sup>51</sup> (1907) 24 R.P.C. 108

<sup>52</sup> (1924) 26 O.W.N. 77

<sup>53</sup> [1942] O.R. 307



case, the patentee, operating under the terms of the agreement, terminated the license to use patented egg cartons due to the licensee being six months behind in making royalty payments.

The agreement provided, inter alia, that in the event of termination of the license

"nothing herein contained shall release the Licensee from the obligation to pay the royalty then already accrued at the date of such termination, nor relieve the Licensee in any way from the position of an infringer, if he continues thereafter to use the invention without a new license..."

The patentee brought action for arrears of royalties under the agreement and for damages for infringement of the patent after the determination of the agreement by the plaintiff. The defendant set up the invalidity of the patent.

Hogg J. adopted the familiar estoppel doctrine and rejected the plea of invalidity with respect to royalties due under the agreement. With respect to the infringement action, Hogg J. noted that in the absence of any agreement a user of a patent could be sued for infringement and would often adopt the defence that the patent was not valid. If the defence succeeded, the defendant would not be an infringer. In the instant case, the licensee had agreed that should the license be terminated, he would not be relieved from the position of an infringer. Therefore, reasoned Hogg J.<sup>54</sup>

"The conclusion completing the syllogism, to be deduced from these premises, is that the

<sup>54</sup> Ibid. p.312

plaintiff's patent in so far as the defendant is concerned is valid. I am therefore of the opinion that the defendant is estopped, or possibly the proper word to be used should be, restrained...from denying that the plaintiff's patent is a valid patent."

Taken as an exercise in syllogism, the minor premise that has been used is that the defendant was an infringer. From this the conclusion will flow that the patent was valid. The deceptive aspect to this lies in Hogg J. accepting as a minor premise the matter that he was to resolve. Accordingly, the argument is circular. What he in effect was doing was giving the clause "the position of an infringer" quite an artificial meaning. In ordinary parlance one may refer to an "infringement" action rather than an "infringement or a non-infringement (depending on whether the patent is valid)" action. To adopt the artificial construction accepted by Hogg J. is tantamount to saying that once a license is entered the licensee is estopped from denying the patents validity either during or after termination of the license. This is quite contrary to the spirit of the decision reached by the House of Lords in Crossley v. Dixon.<sup>55</sup>

<sup>55</sup> Supra note 27, Chapter 2.

4. Estoppel of Assignors and Unresolved Difficulties in the General Rule.

It is broadly accepted that an assignor of patent is estopped from pleading the invalidity of the patent.<sup>56</sup> This rule was first stated in 1789 in Oldham v. Longmead a case that is cited in Hayne v. Maltby.<sup>57</sup> That there are some different principles underlying the rule of assignor estoppel as against assignee estoppel can be seen from the manner in which Lord Kenyon distinguished Oldham v. Longmead (a case that he had himself decided) from the facts in Hayne v. Maltby. It will be recalled that in Hayne v. Maltby, the much distinguished earliest case in the area, the assignee was permitted to plea invalidity basically because the court was of the view that to deny the plea would overlook a complete failure of consideration. There would never be any scope for a failure of consideration argument related to the validity of the patent to be raised by an assignor. The usual rationale given to preventing the assignor from challenging validity is that he should not be permitted to derogate from his own grant.

Some of the early cases on assignees attempting to challenge validity were based on the ground that there was no implied warranty of validity in the assignment (see especially Bowman v. Taylor<sup>58</sup>). This style of argument was made in

<sup>56</sup> Fox p. 319; Terrell p.215

<sup>57</sup> Supra note 2

<sup>58</sup> Supra note 8



Chambers v. Crichley,<sup>59</sup> but on this occasion it was the assignor who was seeking to challenge validity in an action brought by the assignee for infringement of the assigned patent. The defendant argued that as he had not warranted the validity of the patent, there was nothing in the assignment to prevent him challenging its validity. The Master of the Rolls rejected this argument on the ground that he would not permit the assignor to derogate from his own grant.

This leads to what may seem a paradox: an assignee cannot plead invalidity because validity is not warranted yet the assignor is not permitted to show that there was no validity. Put in more drastic terms: the assignor is allowed to sell virtually nothing but is not allowed to prove that he did so. In fact, this is no more a paradox than the traditional "shield but not a sword" basis of estoppel in general.

This does not end the matter, however, because if one is to have a rule against an assignor derogating from his own grant and this is to be the only scope of "assignor estoppel" one needs to know the nature of the grant from which there may be no derogation. This raises difficulties in analysis because "grant" embraces two distinct but possibly related elements: first, the character of the transfer and second the object of the transfer. With the first element, one may suppose differences to arise according to whether the transferor had sold the rights for a

<sup>59</sup> (1864) 33 Beav. 374; 33 E.R. 412

considerable sum of money or had gained no direct advantage on the immediate transfer due to it taking place as a gift or, say, in an involuntary way due to it being an assignment in bankruptcy. Quite probably there will be various shades of grey to be found with the extremes, if extremes there should be. The second element must reopen the whole issue of what is the nature of the rights that can be transferred and should overlap significantly with the questions of what an assignee acquires. Finally, some interrelating between these elements is to be expected if the problem is regarded as one of construction of the assignment agreement and determination of the intention of the parties.

Whilst the separate elements just delineated were not recognised as such, the Court of Appeal in Cropper v. Smith and Hancock<sup>60</sup> had cause to examine the first element. One of the defendants was the inventor and original patentee. His patent rights had passed to the plaintiff through the plaintiff having purchased the rights from the trustee in liquidation when at an earlier time the defendant had gone into liquidation. It was held that there was no estoppel, although on a procedural point, the majority of the court held that the defendant had not made a proper plea of invalidity and hence was prevented from using the patent despite the fact that it had been declared invalid. The House of Lords reversed<sup>61</sup> the decision on the procedural matter

<sup>60</sup> (1884) 26 Ch.D. 700; 1 R.P.C. 81

<sup>61</sup> (1885) 10 App.Cas. 249; 2 R.P.C. 17

having agreed with the Court of Appeal on the substantial issue.

In Cropper v. Smith there were additional arguments that may have given rise to assignor estoppel, being directed in effect to an argument of patentee estoppel. It was argued that there was

- (i) estoppel by record - the record being the patent;
- (ii) estoppel by deed - the patent having been sealed;
- (iii) estoppel in pais - the conduct in question being the act of presenting a petition to the crown in which was made the representation that the invention was a new invention.

Arguments (i) and (ii) were rejected by the court on the basis / that novelty was not alleged as such in the specification, but instead it was directed to the method of carrying out the invention. On argument (iii), Cotton L.J. concluded<sup>62</sup> that, if it had been necessary to decide

"That would ... be good as an estoppel in pais as against any one who is interested and who is proved to have acted in reliance on the statements which were made in the petition to the crown... but here there is no evidence that the plaintiffs in any way relied on the (petition)."

Cotton L.J. noted the very small sum paid by the plaintiff for the patent and also expressed doubt on whether purchasers ever placed reliance on the petition alone.

<sup>62</sup> 1 R.P.C. 92.



It would appear from the rejection of the above arguments that the grounds on which an assignor will not be permitted to later dispute the validity of a patent arises only through being a party to the assignment agreement.

Whilst not completely rejected, the estoppel in pais argument was given such limited scope that it could be put on its own and if argued at all it would be as a secondary argument to one based on the impact of the assignment agreement.

Very real difficulties may arise in applying an estoppel rule as is indicated in Heugh v. Chamberlain<sup>63</sup> which is valuable mainly through highlighting an awkward fact situation. In this instance the patentee assigned his patent and later went into partnership with another person with whom he carried out a process which the assignee alleged infringed the patent. It was the partner of the assignor who contested the validity of the patent. The plaintiff argued that as the assignor was estopped from denying validity so should his partner be estopped. Jessel M.R. rejected this argument.

The same problem as that of Heugh v. Chamberlain arose in a less direct fashion as another aspect of the Cropper v. Smith and Hancock case. As was noted above, in that case the assignment having been through operation of law from the patentee meant that he was permitted to raise invalidity. It was on procedural grounds that the majority of the Court of Appeal found

<sup>63</sup> (1877) 25 W.R. 742.

against him. However in Cropper's case there were two defendants, the patentee and his partner and it was the partner who successfully challenged validity. The difficulty arising from the Court of Appeal's result was that there was a successful defendant who was permitted to carry out the process and the unsuccessful defendant who was ordered not to use the patent, despite its declared invalidity, and was ordered to deliver up for destruction all apparatus used in the process. Quite understandably the House of Lords heaped scorn on the absurdity of this result - the apparatus to be destroyed was property of the partnership and hence related to the successful defendant as well. In the light of this, the House of Lords reversed the decision of the Court of Appeal on the procedural aspect and thus found for both defendants.

Unnoticed by the House of Lords was the problem that could arise if the patentee had assigned for consideration and hence would have the ordinary rule applied and would have been estopped from denying validity. Then one would have had the same result as the Court of Appeal, although on different grounds.

Perhaps what this does is to concentrate attention on the second element of "grant", the object of the transfer. Could one say that the assignor sells a proprietary interest that he will not directly derogate from but that he retains a potential

right to use the subject matter of the patent if someone else successfully challenges its validity? If this was the case, one would have quite a stark contrast with the position of patent licensees who are not permitted to use a patent freely even after it has been declared invalid. It would also open the way to the simple device of challenging validity through a partner that a patentee could acquire after assignment had taken place.

Instead of attempting any in depth analysis of the problem, an inflexible "assignor estoppel" rule has tended to be applied. Whiting v. Tuttle<sup>64</sup> applies an assignor estoppel rule with a strange confusion of policy arguments. Gillies v. Colton<sup>65</sup> indicates further difficulties in applying the rule automatically. In this case, the Ontario Court of Chancery did not engage in any analysis of the nature of the transactions but applied the rule as soon as it was determined that the defendant was an "assignor". The defendant Colton had financed and supplied premises to one Collard who was a patentee of inventions related to harrows and cultivators. Collard was to manufacture the equipment and Colton was assigned exclusive rights under the patents to sell the equipment in Canada and U.S.A. Later, difficulties arose in the relationship and, by deed, Collard returned the premises to Colton and Colton assigned the interests in the patents back to Collard. Collard later assigned his

<sup>64</sup>  
(1870) 17 Gr. 454

<sup>65</sup>  
(1875) 22 Gr. 123



patents to the plaintiff. Upon the plaintiff bringing action for an injunction to refrain the defendant from infringing the patents, the defendant pleaded that the patents were invalid. It was conceded that the patents were invalid but it was held that as he had once assigned the patents, the defendant was estopped from denying their validity.

It is hard to see how Colton could have been regarded as derogating from his grant. The grant, if faulty, was faulty only because it was that way when he received it and he returned it rather than passing it on. If any analysis on standard principles had been made it is unlikely that a court would conclude that the inventor Collard was getting back anything more than received and the arrangement having been complete it would ill-behave Collard to deny Colton a challenge to the validity. That being the case, the plaintiff Gillies should not have been in any better position.

A similar dubious application of the rule was made in Gonville v. Hay<sup>66</sup> where a patent taken out by inventor McC was licensed to H who executed a declaration of trust of the benefit of the license to the partnership consisting of McC, H, M and G. On dissolution of the partnership with G selling all his partnership interests to McC, H and M, the question arose of whether G could contest the validity of the patent. It was held

<sup>66</sup> (1903) 21 R.P.C. 49

that he was estopped from doing so because he had assigned his interest and therefore he could not challenge its validity.

In the last two cases, it is the lack of attention given to the first element of "grant", the character of the transfer, that gives rise to the result. If this element was properly received, these cases would be seen to be analogous to the Cropper case where the transfer was by the trustee in liquidation and hence estoppel did not apply. This is not because the transfer is involuntary, but because the transfer would not seem to be a deliberate act but purely incidental to restoring an earlier situation.

If the courts were to reassess the assignor estoppel rule in order to avoid some of the problems arising from the rule, a different policy approach that may avoid most of the difficulties would be to make validity an implied term of most assignments. It would not be implied where the transfer was not voluntary or merely incidental etc. This would allow the assignee to sue for damages if the term was breached by the assignor later successfully challenging validity. Such a policy change would have a significant double effect, however, in that it would permit the assignee to challenge validity to prove a breach of the term. This would do away with the assignee estoppel rule and hence the lack of adoption of this approach is understandable.

### 5. Scope of a Patent and Prior Art.

A licensee and a patentee (or the current holder of the patent) may come into dispute if the patentee claims royalties on goods being manufactured or on a process being used by the licensee and the licensee refuses to pay because he regards the goods or process in question as being outside the scope of the patent. The issue then becomes what is the scope of the patent? Some very real difficulties then arise due to the estoppel operating against the licensee which prevents him from showing invalidity. The same difficulties can arise through assignor estoppel, if a patent holder alleges that the person who assigned the patent to him is infringing.

The source of the difficulty is that the scope of a patent has a lot to do with prior art and prior art has a lot to do with novelty which is a requirement for validity. An analysis of scope without the possibility of also reviewing validity can be a difficult and sometimes impossible task.

In an infringement action a defendant may raise two defences: that his activity is not within the scope of the patent and the patent is invalid. This puts some pressure on the patent holder. On the one hand, he will be anxious to have the claims of his patent construed as broadly as possible in order to embrace the activity of the alleged infringer, but on the other hand, he will need to seek a construction that will not have his



claims declared invalid either through their lack of novelty over the prior art or through their going beyond what he has revealed. It is in preparation for such a contest that patent specifications are drafted as they are. Putting aside the general problems in the estoppel rule, some specific problems arise on questions of scope of a patent due to invalidity being a different matter in modern specifications than what it was in times when the rules first emerged.

It was not until the Patent Act of 1883<sup>67</sup> that it became compulsory to conclude a specification with a claim or claims defining the scope of the invention. For specifications without any claims and in later times with specifications where the claim relates back to what has been described, the scope of the invention would have to be determined by a consideration of the specification as a whole with the question being posed: what are the essential features of the invention as disclosed? In answering this question, it would be necessary to know something of the technical field in which the invention was made and it would often be necessary to have some detailed knowledge as to earlier inventions that had sought to achieve similar ends. Accordingly, an examination of the prior art would be a desirable and sometimes essential exercise. When one discovered in the prior art an invention with similarities to the one under examination, there would be a tendency to distinguish the inventions and characterize as essential features of the new

<sup>67</sup> 46 & 47 Vict. c.57.

invention any of its features that varied from the prior invention. Therefore, a court that was faced with resolving a contest between a patent holder and a licensee on the question of the scope of the patent would be able to place reliance on evidence of the prior art without becoming directly caught up in questioning the validity of the patent.

The situation changes significantly when the patent has free-standing claims. The scope of the patent should then be ascertained by construing the claims alone with the only role to be played by the body of the specification being that of a dictionary for unusual terms that may be used in the claims. Prior art should have a still more remote function, being used only to clarify terms that remain uncertain in meaning after inspection of the body of the specification.

The task of construing a specification in the light of the prior art to determine the essential features of an invention is still performed today but it is performed by a patent examiner before the patent is issued and then possibly by a court if the validity of the patent comes before it. If a patent examiner is of the view that any of the claims of the invention fail to include all the essential features at a reasonable level of abstraction he will report that the claim is not fairly based on the invention as described and will not accept it without it being

appropriately amended. Amendment is not called for by a court that comes to a similar conclusion, it simply declares the claim invalid.

Reference to the prior art in determining the essential features of an invention is not for the same purpose as determining whether a claim is anticipated by the prior art or not novel in the light of it. Whilst the objects are not the same it is of little significance in practice at the examination stage of a patent application. This is because an objection made by a patent examiner that the claim is not fairly based because the elements of the invention are spelt out in over-broad terms in the claim amounts to the same thing as there being no objection on lack of fair basing, but an objection is made that the claims are anticipated by prior art. This latter objection often arises simply because the claims have been drafted so broadly that they embrace prior art as well as the invention described. Similarly, there is often no practical difference between these things when a court is concerned with validity in that the offending claims will simply be declared invalid.

It is clear that when the courts first constructed the rule of licensee estoppel, the modern method of claim drafting was not being contemplated. Doubtless an answer to the question: when you say validity cannot be challenged by a licensee what do you picture as "validity"? would be answered along the lines of



preventing the destruction of the heart of the patent. Possibly expressions familiar in old cases along the lines of "pith and substance of the invention" would be used. Nonetheless, the challenge to "validity" cannot be made today despite the significant shift in the meaning of "validity" in modern patent specifications. A whole series of claims are customarily used in patents nowadays with the claims starting at a high level of abstraction and then narrowing claim by claim as each element is qualified to bring it closer to the embodiment of the invention that is specifically disclosed. Sometimes it will hurt the patentee very little to have the broader claims declared invalid because their broadness leads to them going beyond what has been disclosed or allows them to embrace matters known in the prior art. To allow the broadest of claims to remain unchallenged will be to give a broader scope to the invention than what was permitted when the notion of licensee estoppel first emerged.

Implied recognition is given to the difficulty just outlined in the approach that courts have occasionally adopted in determining the scope of the invention. Unfortunately, this has been at the expense of doing violence to the traditional methods of construction. Reference to the cases illustrates the confusion that has crept into this area.

In Clark v. Adie (No. 2),<sup>68</sup> a case that has already been discussed in part on its general statements on licensee

<sup>68</sup> (1877) 2 App. Cas. 423.

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<sup>68</sup>  
(1877) 2 App. Cas. 423.

estoppel, the main point at issue was the scope of the patent that had been licensed. The defendant was permitted to bring in evidence on the prior art. All the members of the House of Lords stated that they had not needed to make reference to that evidence because it was clear on the face of it that the hair-clippers manufactured by the defendant-licensee fell within the scope of the patent. Nonetheless, some comments were made of the role that such evidence could be allowed to play. Lord Hatherley and Lord Blackburn both rejected the use of evidence of prior art to exclude from the scope of the patent old material.<sup>69</sup> Lord Hatherley said that the construction of a patent should not be approached on the assumption that the applicant did not intend to include anything that had been previously invented.

The attitude adopted in Clark v. Adie (No.2) was implicitly followed in Jandus Arc Lamp et al v. Johnson<sup>70</sup> where Farwell J. rejected evidence of former specifications because he regarded those specifications as being relevant only on the question of validity, a matter that could not be challenged by the licensee. Despite this, he stated that he would adjudicate only in the light of common knowledge at the time that the specification was lodged, thus inferring that prior art had relevance that possibly went beyond use as a dictionary.

<sup>69</sup> Ibid. pp. 433, 437

<sup>70</sup> (1900) 17 R.P.C. 361, 376



A similar limitation on the use of evidence of prior art is to be found in Campbell v. G. Hopkins & Sons (Clerkenwell) Ltd.<sup>71</sup> where Eve J. did not permit the defendant to put to a witness for the plaintiff a prior patent specification in that he regarded its only function would have been to impugn the validity of the patent under examination.

Sensitivity to the need for upholding the licensee estoppel rule is demonstrated to the full by Thorson J. in Clark v. McDermott<sup>72</sup> when he rejected argument by the defendant on evidence that had been extracted by the defence cross-examination of the original inventor. The inventor had assigned the patent to the plaintiff and had been called as witness for the plaintiff. Thorson J. in reference to his findings on what were the essential features of the invention said;

"Quite apart from the danger involved in allowing an inventor, many years after the date of the invention, when it no longer belongs to him, to say what he considered an essential of it and thereby possibly invalidate his own claim..."

This approach has full regard for the estoppel rule and also is in accord with traditional rules of construction of the specification. What it does throw in doubt is the function of such a witness (supposing that such a witness should be permitted in the first place) if that witness can only be allowed to give evidence which, in effect, is favourable to the plaintiff only.

<sup>71</sup>(1933) 50 R.P.C. 213, 218

<sup>72</sup>(1964) 26 Fox Pat. c.158

An altogether different attitude to evidence on prior art is expressed or implied in various other cases. Quite probably there are further examples to be found hidden in the reports because the methods of construction adopted are seldom highlighted in the judgments and hence do not gain attention in the digests. The following cases, virtually none of which makes reference to earlier authority, illustrate the lack of direction to be found in the area.

Counsel for the defendant in Trotman v. Wood<sup>73</sup> urged that evidence on prior art that had been admitted should be used as an aid in determining the scope of the patent at issue. He argued that if two constructions were available to the patent specification one which would render it valid and the other, wider construction which would render it invalid then the construction to be selected was the one that gave the patent validity. Byle J. stated that he had not needed the assistance of the evidence as such but if it had been necessary for him to rule on whether it had been correctly received, he would have thought that it had been on the ground put forward by counsel. Erle C.J. was more reserved, holding that such evidence could be received to throw light on the meaning of the words in the specification but not to alter their meaning from that normally accepted.

In another old case, that of Couchman v. Greener<sup>74</sup> which was finally decided at the level of the House of Lords, a

<sup>73</sup> (1864) 16 C.B. (N.S. 479; 143 E.R. 1214

<sup>74</sup> (1884) 1 R.P.C. 197

clear reliance on prior art evidence was demonstrated. At the Court of Appeal level the Master of the Rolls said:

"It is true to say that if there be any doubt on the construction of the plaintiff's patent you may look at former patents for the purpose of seeing what is the proper construction of the plaintiff's patent."<sup>75</sup>

No criticism of this approach was made by the House of Lords in dismissing the plaintiff's appeal. Lord Blackburn, after noting that the defendant could not deny that the patent was good proceeds to determine the scope of the patent with a construction based on the assumption that the patentee and everyone else would know that "improvements in guns whereby..." as claimed should be read accordingly. That is, he rejected constructions that may have embraced prior art.

An inclination to determine the scope of patents by taking regard of evidence of the state of prior art is also apparent in the cases of Ashworth v. Roberts,<sup>76</sup> Young and Beilby v. The Hermand Oil Co. Ltd.,<sup>77</sup> Neil v. Macdonald,<sup>78</sup> Davies v. Curtis & Harvey Ltd.,<sup>79</sup> and Dobson v. Adie Bros. Ltd.<sup>80</sup> It would seem that the dicta in Clark v. Adie<sup>81</sup> which stated that evidence of prior art could be acceptable led to evidence along these lines

<sup>75</sup> Ibid, p.199

<sup>76</sup> (1892) 9 R.P.C. 309 (C.A.)

<sup>77</sup> (1892) 9 R.P.C. 373 (H.L.)

<sup>78</sup> (1903) 20 R.P.C. 213

<sup>79</sup> (1903) 20 R.P.C. 561 (C.A.)

<sup>80</sup> (1935) 52 R.P.C. 358

<sup>81</sup> Supra



often being admitted as a matter of course with the restrictions on the proper use of such evidence as indicated in Clark v. Adie, being overlooked in later cases. Once such evidence is admitted, the way in which it is actually used can often become buried in the steps involved in construing a specification. There is one case where the technique of construction was overt and it is an interesting extreme. In Pytchley Autocar Co. Ltd. v. Vauxhall Motors Ltd.<sup>82</sup> Groom-Johnson J. said:

"I must apply to this specification and the language of it, if I can such construction as to give validity to each and every part of it. Ut res magis valeat quam pereat is a maxim which I suppose applies to this class of document as to any other document which the Court is called on to construe at least where, as here, the Defendants are debarred by their (licensing) contract from seeking...directly or indirectly to destroy it."

This quote is interesting because of the way it illustrates a sympathy for the licensee's cause whilst upholding the estoppel rule. The by-product, in the form of application of the ut res magis maxim, flies right in the face of the acceptable methods of construing patent claims.

Although the matter of prior art was directly at issue the function to which it could be put is not clear in Loudon v. Consolidated-Moulton Trimmings Ltd.<sup>83</sup> In this case, an application by the defendant - licensee for discovery of documents relating to prior art was opposed by the plaintiff - patentee.

<sup>82</sup>(1941) 58 R.P.C. 287

<sup>83</sup>[1956] O.W.N. 552; 15 Fox Pat. c.167

In a hearing before Marriott, Senior Master, it was argued that validity could not be questioned. This point was accepted but it was said that since there was no suggestion by counsel for the defendant that the documents be used for that purpose, an order was made for the plaintiff to produce all documents in her possession relating to the scope of the patent.

It would seem that unless violence was to be done to the usual methods of construing patent claims, no purpose could have been served by the discovery of these documents. If they had later been admitted in evidence (the case is not further reported) there is no telling what way they may have been used.

The irony of the situation is that whether he be permitted to do it overtly or not, the licensee as defendant in a case involving the scope of a patent will be attempting to press a construction that will be consistent with validity. Meanwhile, the patent holder, as plaintiff, will not be concerned as to whether the construction of the patent claims that he wishes to have adopted would lead to invalidity of the claims if that matter was at issue. As the creation of this situation all arose from notions of estoppel, it would be consistent with that theme for a patent holder to have the wide scope of his claims made a matter of record that could be used against him if a later infringement action leads to the validity being challenged. However, no attempts have been known to follow matters through in this way and so it remains open

to a patent holder to gain a wide construction of his patent  
in a licensing matter and safer, narrower construction in an  
infringement matter.



#### 6. Licenses Limited in Area.

The scope of the license may at times be argued by a licensee without the scope of the patent being at issue. This can occur when the license grants to the licensee use of the patented article or process to a restricted geographical area. It may also occur if the area of activity is limited by, for example, restricting use of the patented article to just one of its possible functions.

The function of a license is to make the licensee immune from an infringement action. Accordingly any activity outside the licensed geographical area or outside the licensed area of activity should be subject to an infringement action rather than an action on the license. If the matter relates to infringement only the validity is open to challenge. This gives rise to another discontinuity in that the rule relating to estoppel prevents a licensee who alleges that an activity is outside the scope of the license due to it being outside the scope of the patent from challenging validity yet a licensee who may concede that his activity is within the scope of the patent but denies that it is within the scope of the license may challenge the validity of the patent. This is an interesting result indeed, in that the analysis that has been made in this Chapter of the earlier cases indicates that the estoppel rule initially emerged from an exercise in construction of licensing agreements.

The origin of the estoppel rule may now be buried but the rule itself retains coherence by allowing a successful challenge of validity when a licensee demonstrates his activity is

outside the area of the license but, *semble*, insisting on performance of licensee's obligations under the license even when invalidity of a patent is demonstrated.

That this difference arises between scope of license with respect to area and scope with respect to the scope of the patent was accepted in Fuel Economy Co. Ltd. v. Murray.<sup>84</sup> The license at issue authorised the licensee to work the patents within a limited area. The plaintiff alleged that the defendant had sold and installed the boilers covered by the patents outside the authorised area. The defendant denied infringement and pleaded that the patents were invalid. The plaintiff moved to have the plea of invalidity struck out and argued estoppel. Luxmore J. held that estoppel can only operate in the same transaction as that in which it arises and as the action was not based on the license but was an infringement action, no estoppel arose. On appeal to the Court of Appeal the decision of Luxmore J. was upheld.

The decision in Fuel Economy Co. Ltd. v. Murray was supported by dicta in V. D. Ltd. v. Boston Deep Sea Fishing & Ice Company Ltd.<sup>85</sup> where the patented equipment was used in fishing vessels other than those permitted under the licensing agreement.

<sup>84</sup> (1930) 47 R.P.C. 346

<sup>85</sup> (1935) 52 R.P.C. 303

### 7. Estoppel on Arguing Scope

From the viewpoint of the licensee of a patent the whole area may seem to be almost enclosed by potential estoppel in that as well as the familiar estoppel against challenging validity, there is some authority for his being estopped from challenging the scope of the license in some circumstances.

The case of Baird v. Neilson<sup>86</sup> provides a fairly straight forward example of estoppel arising through the recitals set out in an agreement which had been made to resolve a dispute between the patentee and licensee. A license for a patent involving the smelting of iron by the use of heated air had previously been granted to the defendant and he had paid one shilling per ton of iron smeltered by him until a dispute arose and payments were stopped with the defendant arguing that the patent was invalid and that he was operating outside of the scope of the patent. A suit by the plaintiff was terminated when the parties entered a new agreement that commenced with a recital of the dispute and then continued a covenant that the licensee would make a lump sum payment for iron previously smelted and would pay one shilling per ton for the term of the patent for all iron smelted by the hot air process covered by the patent. The plaintiff brought action against the defendant for failing to provide records of the amount of iron processed and for non-payment of the royalty due under the second

<sup>86</sup> (1842) 8Cl. & Fin. 726; 8 E.R. 285.



agreement. The defendant again pleaded that the patent was invalid and that he was not operating within the patent.

The House of Lords construed the second agreement on the basis that the process covered by the agreement was the process that had been carried out by the defendant before and after that agreement and whether that process was within the scope of the patent or not, the defendant could no longer raise the defence that it was outside it.

A much more recent case and one with a high potential impact in the patent licensing field is Lyle-Meller v. A. Lewis & Co. (Westminster), Ltd.<sup>87</sup> In this instance the plaintiff granted an exclusive license to the defendants to manufacture gas-filled lighters. Royalties were to be paid on each lighter or refill sold by the defendants with the plaintiff reserving the right to determine the agreement in the event of total royalties not equalling Two Thousand Pounds a year. During the next two years, the defendants made lighters and paid royalties in excess of Two Thousand Pounds a year. At the end of the next year the defendants rendered a statement to the plaintiff detailing the number of lighters made and the royalties paid and showing that over Seven Thousand Pounds was still payable. Shortly afterwards, however, the defendants repudiated liability. When the plaintiff brought action for the amount outstanding, the defendants stated, inter alia, that the previous payments had been

<sup>87</sup> (1955) 72 R.P.C. 307; (1956) 73 R.P.C. 14 (C.A.) [1956] 1 All E.R. 247.

made in mistake and that no royalties were due because it was claimed that the lighters and refills had never embodied the plaintiff's invention.

The Court of Appeal held that the defendant was estopped from denying that the lighters and refills fell within the plaintiff's invention. Hodson L.J. and Morris L.J. found that the defendants were estopped at common law because by their conduct they had represented that the goods were within the plaintiff's invention, they had intended the plaintiff to act on this representation and he had acted on it to his detriment since he had refrained from ending the agreement and exploiting his invention elsewhere. In reaching this conclusion, both Hodson and Morris L.JJ. extracted the test stated by Lord Tomlin in Greenwood v. Martins Bank Ltd.<sup>88</sup> Some concern was expressed as to whether the representation that the goods manufactured and sold by the defendants embodied the invention was a representation of fact or one of mixed fact and law. Morris L.J. concluded that it was one of fact. Hodson L.J. also thought that it was one of fact but even if it was a mixed fact and law issue, this would not destroy the estoppel.

Denning L.J. thought that the representations may not fall within the category appropriate for common law estoppel in that strictly speaking, this was restricted to representations of existing fact. In any event, he was unwilling

<sup>88</sup> [1933] A.C. 51, 57.

to regard the case as one falling within the common law estoppel because he doubted whether the defendants could be held to an arithmetical mistake made in rendering the accounts for the number of lighters made. The answer to the whole issue, in the view of Denning L.J. was to be found in the "new estoppel" which applied to representations as to the future and applied to representations about legal relations. The "new estoppel" was the one born in Central London Property Trust Ltd. v. High Trees House, Ltd.<sup>89</sup> and confirmed in Tool Metal Manufacturing Co. Ltd. v. Tungsten Electric Co. Ltd.<sup>90</sup>

In the Lyle-Meller case, the plaintiff was suing for past royalties due and in this he succeeded. What is not clearly indicated in the decision is the possibility of the defendant being able to contest the issue of scope if he refused to pay any further royalties. It would seem that this possibility was open and hence the estoppel differs somewhat from the estoppel applying to contesting validity. On the approach followed by Denning L.J. it would be open to the defendant to clearly indicate a change in attitude and thus allow the plaintiff to move to exploit his invention elsewhere. This would be in accord with the dicta in the High Trees case and also dicta in Tungsten Electric where it was indicated that the size and method of payments could be for the future, returned to the old basis if

<sup>89</sup> [1947] K.B. 130; [1956] 1 All E.R. 256

<sup>90</sup> [1955] 2 All E.R. 657



notice was given. It would also seem that notice would bring about an appropriate change in the relationship on the common law estoppel adopted by Hodson and Morris L.J.J.

The probable result of the Lyle-Meller decision is that a licensee cannot argue that royalties are not payable on goods for which he has previously paid royalties until he gives notice that no further royalties will be paid. The scope of the licensee could then be questioned only with respect to royalties due on goods made or sold a reasonable time after notice had been given.

An exception to this result may and possibly should occur if it is shown that the licensee is one of many and therefore the patentee would not have had any practical way of exploiting his patent through other sources even if notice had been given. That is, some impact should be given to the modification-of-behaviour element that is found in both species of estoppel.

## 8. Summary of the Growing Pains on Estoppel in the Patent Field.

Various criticisms have been made in passing during this account of landmarks in the development of the estoppel rules applying to patents in Canada today. A general observation that can be made at this stage is that despite the fairly clear line of development of the general rules, the law has become divorced from the overall fields of law from which it emerged. This is even putting aside the way in which the development of the law has virtually ignored the restraint of trade aspects that it has embraced. This will be taken up in the next chapter.

The dubious aspects to the pedigree of the patent estoppel law can now be summarised:

- (1) Estoppel by deed: Bowman v. Taylor in 1834<sup>91</sup> was the first case that held the licensee was estopped from denying validity of the patent through a recital in the deed. This was probably a dubious result even then in that the only significant word in the recital was that the plaintiff had "invented" the subject matter of the patent. From this emerged a construction of first and true inventor etc. Possibly then and certainly now, the raising of implications would not be enough for estoppel. Even if the implication arising from the word "invented" was permitted to raise some form of estoppel, there are

<sup>91</sup> Supra note 8

a host of other matters - utility, full description, etc. - that go to the validity of a patent and estoppel on these issues cannot be supported.

Another matter of significance is that estoppel by deed should only relate to questions of fact. There is little doubt that the validity of a patent is, on many aspects, a question of law and hence estoppel by deed should not apply.

- (11) No implied term of validity: Hall v. Condor<sup>92</sup> in 1857 was the first case to be directly based on the lack of any implied term in an assignment agreement that the patent be valid. As there was no implied validity proof of invalidity was an irrelevant matter and hence evidence along those lines was inadmissible. The decision at the time may have been reasonable, made as it was in an atmosphere of laissez-faire with caveat emptor dominating all transactions. Noteworthy in that case is the analogy with ascertained chattels the sale of which was said to have no implied terms on title and quality. This was certainly not the case by the time the law was codified in the Sale of Goods Act some 30 years later. The evolution of the law of contracts since Hall v. Condor has seen a far greater willingness of the courts to imply terms. In any event, the test used as an aid to construction in Hall v. Condor

<sup>92</sup> Supra note 19



re the comparative knowledge of the parties would give a different result in most instances if it was applied in later years. However, instead of the circumstances being examined in each instance to determine the intention of the parties, an exercise that would have allowed the construction of agreements to keep pace with the law of contracts overall, the result reached in Hall v. Condor became an automatic result whenever assignment or licensing of a patent was involved.

- (iii) Failure of consideration: On many occasions in the early evolution of the law the argument was pressed that an agreement to license or assign a patent would be bad for failure of consideration if the patent was invalid. This argument found favour in Hayne v. Maltby<sup>93</sup> in 1789 but it was rejected with increasing irritation as lack of consideration became a near irrelevant issue, through the nineteenth century. With the revival of concern for consideration that is indicated by the doctrine of fundamental obligation, it would seem that no thought was given to reprocessing agreements involving patent licensing and assigning to determine whether the invalidity of a patent could, in some circumstances at least, constitute a fundamental

<sup>93</sup> Supra note 2

breach. Whatever status the doctrine of fundamental obligation may enjoy since Suisse Atlantique etc. it would seem that patent agreements may be viewed differently nowadays if the whole question could be raised anew.

- (iv) Changes in patent legislation: In discussing difficulties in determining the scope of an invention<sup>94</sup> the changes brought about since 1883 when claims became compulsory were mentioned. Questioning the validity of the wider claims of a modern patent specification is quite a different matter to challenging the entire existence of the patent, which was the effect of the early contests. Quite a different matter but one that should go to the core of this topic is the provision permitting challenge of a patent.

No case can be found where the question has been argued but what is it that prevents a licensee or assignee from qualifying as the "anyone" who is permitted to challenge the validity of a patent? Quite probably there would be a strong argument presented that common law principles are to be respected and the section is not sufficiently specific to override the established rule. Nonetheless, if the point had been taken it may have been accepted that the common law rule had not become so entrenched as to colour the interpretation of a word that gives all appearances of being all-embracing.

<sup>94</sup> Supra note 67.

CHAPTER THREE1. Introduction

In the last chapter, the development of the estoppel doctrine in patent licensing and assigning was discussed with some of the problems in its application being highlighted. These problems were considered in the light of general contract law in its intermesh with patent law. In this chapter, the discussion is broadened to take into account matters that were left almost untouched in the last chapter. These matters involve principles to be found in the restraint of trade notions of the common law, competition law as reflected in broad legislative provisions and specific provisions relating to abuse of patent monopoly.

The lack of judicial recognition given to potential restraint of trade aspects to be found in the licensing of dubious patents is, in retrospect, quite a glaring omission. Stripped of the veneer provided by its precarious status as a patent, the licensing of an invalid patent is a blatant contract in restraint of trade. By preventing a licensee from demonstrating the invalidity the blatancy is merely muted. Recognition of this point is to be found in Hayne v. Maltby,<sup>1</sup> the case that was subject to much discussion in the last chapter. For the major cases of the nineteenth century, however, one finds only the occasional comment

<sup>1</sup>(1789) 3 T.R. 439



by defence counsel on the restraint of trade implications with very little judicial sympathy being accorded. This attitude was consistent with the low priority given to restraint of trade in the laissez-faire atmosphere of the time.

Passing reference was made to restraint of trade in two early Canadian cases that were discussed in the last chapter on the question of assignor estoppel. In Whiting v. Tuttle<sup>2</sup> the defendant was the inventor and patentee who had worked the patent in partnership with the plaintiff. It was when the partnership dissolved and the defendant sold his entire partnership interests to the plaintiff that the patent was assigned. The gist of the defence argument appears to have been that the defendant's new activities in manufacturing elsewhere goods that fell within the patent could not be stopped on the basis of restraint of trade resting on goodwill, because it would be too wide in scope. That being the case, it was argued that the same result should not be reached indirectly by preventing a challenge on what was alleged to be an invalid patent. It would seem that Strong V.C. did not grasp the implications of this argument in that once he found what he regarded to be a clear assignor estoppel rule, he was of the view that he need not pronounce on the further questions.

A similar misunderstanding of restraint of trade implications appears to have occurred in Gillies v. Colton<sup>3</sup> where the point was argued strongly. Proudfoot V.C. observed<sup>4</sup> that he saw

<sup>2</sup> (1870) 17 Gr. 454

<sup>3</sup> (1875) 22 Gr. 123

<sup>4</sup> Ibid. p.129

no restraint of trade violation because the defendant was restored to the condition of the rest of the population. This would have been a reasonable response if the patents were valid but as it was conceded at the trial that the patents were invalid, the whole impact of the assignor estoppel conclusion reached by Proudfoot V.C. was to prevent the defendant from attacking the patents in the way that the rest of the population could do.

The above two cases were not ones where there was any specific provision in the assignment stipulating that the validity of the patents would not be challenged. The conclusions rested on the rule on assignor estoppel alone. In the light of developments in the restraint of trade field since those cases, it is possible that a different result may be appropriate.

Doubts were expressed on the estoppel doctrine in the light of restraint of trade considerations by Clauson J. many years ago in the case of V.D. Ltd. v. Boston Deep Sea Fishing & Ice Company Ltd.<sup>5</sup> There was a clause in the licensing agreement that would appear to have been designed to minimise the need to argue the common law implied estoppel. Although he decided the case on other grounds, Clauson J. made the following observation:

"The second (explanation) was that the Defendants had in their license covenanted in general terms not at any time to dispute the validity of the patents. Such a provision has, no doubt, in recent years become common. It would seem, however, to be very remarkable, if a Court which is bound by the provisions of the Statute of Monopolies can be called upon to give

<sup>5</sup> (1935) 52 R.P.C. 303

effect to a covenant between individuals, that which by reason of the statute turn out to be an invalid monopoly and an illegality shall be, as between the parties, held to be valid and legal. Under modern conditions the question seems to me to be so important that it is best that as it has not been argued out before me, I should say nothing more about it."<sup>6</sup>

Whether this dicta had a greater influence than one would normally expect or whether there has been little opportunity for testing the issue is not known, but it is noted that there has been a lack of English cases directly on this point since 1935. The same cannot be said for Canada however, and in Philco Products Ltd. and Cutten-Foster & Sons Ltd. v. Thermionics Limited et al<sup>7</sup> the Supreme Court of Canada had a ready opportunity to adopt this approach but refrained from doing so. In various cases since then, the point has been avoided. The question did not have to be directly grasped but no inclination to do so appears in the judgment of Judson J. sitting alone on an appeal from the Exchequer Court in Curtis-Wright Corp. v. R.<sup>8</sup> A clause in the licensing agreement under examination provided that the licensee would not directly or indirectly dispute the validity of the patent. Judson J. found this to be "simply a contractual obligation inserted to protect the patentee and binding upon the licensee for the life of the existing patent."<sup>9</sup> As the agreement had come to an end, this was held to be not binding. The approach indicated

<sup>6</sup> Ibid. p.331

<sup>7</sup> [1943] S.C.R. 396

<sup>8</sup> [1969] S.C.R. 527

<sup>9</sup> Ibid. p.530



is of more than passing interest because Judson J. in effect eliminated one of the traditional sources of the estoppel rule by holding that the phrase in the agreement "licensee hereby acknowledges the validity of the patents" could not be construed as a representation that could give rise to an estoppel.

The competing interests that can be taken into account increase significantly once restraint of trade implications are included. The traditionally adopted test of Lord Macnaughten in Nordenfelt v. Maxim Nordenfelt<sup>10</sup> requires reasonableness as between the parties and reasonableness in reference to the interests of the public to be considered. Even with a limited focus on the public interest, there is a wide diversity of factors that may be relevant. The better result may lie in an ad hoc approach to patent licenses and assignments rather than attempting to formulate rules of universal application. Be as it may, application of some test of reasonableness within the context of restraint of trade or analogous legislative provisions will be the only device available to put aside specific provisions inserted in agreements that have a similar impact to the common law estoppel doctrine.

With respect to reasonableness as between the parties restraint of trade effects are different for a license agreement than for an assignment agreement. Assuming an invalid patent, there is a continuing restraint brought about by denying a

<sup>10</sup>[1894] A.C. 535, 565

challenge to the validity of the patent either through applying a specific clause of the agreement. With an assignment of a patent there is no continuing restraint on the assignee. For assignments, the person who is placed under a continuing restraint is the assignor.

Once reasonableness in the public interest is taken into account, the grouping becomes different from the reasonableness as between the parties. Licensee, assignee and assignor alike through a successful challenge of the validity of a patent could remove the impediment to public use of the subject matter of the contract and therefore advance the public interest. The same type of considerations apply whether one is considering the interests of the public as contemplated by the common law approach or from the viewpoint of legislation that in many ways continues the spirit of the Statute of Monopolies of 1624.

Dramatic changes in law on estoppel have been taking place recently in the United States of America. Lear Inc. v. <sup>11</sup>Adkins is the landmark decision where the United States Supreme Court ruled that the common law of contracts in its evolution of the doctrine of a licensee being estopped from denying the validity of a patent had to yield to the general public interest requirement of all ideas being dedicated to the public good unless protected by a valid patent. This was not the first attack on the doctrine of estoppel in that a case as far back as 1945, Scott Paper Co.

<sup>11</sup> 395 U.S. 653 (1969)

v. Marculus Manufacturing Co.,<sup>12</sup> can be characterised as an oblique assault on the doctrine. Since Lear v. Adkins there have been further cases that provide explanations and modifications of the new approach. There are certainly differences in the posture taken in the United States of America as against that of Canada in the areas of competition law and patent law. There are sufficient similarities, however, especially on the relevant issues to be found in patent law, for the United States experience to be referred to in the analysis about to be made.

## 2. Licensee Estoppel

The development of the doctrine of estoppel in relation to licensees was shown in the last chapter to rely on factors that may not withstand a modern day reassessment. The estoppel by deed aspect is very dubious and the approach indicated by Judson J. in the Curtis v. Wright case<sup>13</sup> indicates that it is probably no longer tenable. The supposed lack of implied term of validity and the closely related notion of virtually no consideration being required might also be subject to extensive modification on current approaches to these matters. This type of reassessment may lead to estoppel being found unacceptable in cases where the invalidity is established.

<sup>12</sup> 326 U.S. 249 (1945)

<sup>13</sup> Supra note 8



A change along these lines would be in sympathy with the statements made so long ago by the House of Lords in Crossley v. Dixon<sup>14</sup> and Clark v. Adie<sup>15</sup>. It was suggested in Crossley's case that it was open to the licensee to put an end to the licensing agreement and then challenge the validity of the patent. In Clark v. Adie "eviction" was mentioned as a possible ground for refusing to make royalty payments.

In Canadian cases, this approach has not been adopted and accordingly one has the situation of licensee estoppel acting to continue an obligation to make royalty payments despite the patent losing all force due to a successful challenge of validity by a third party or lapse due to failure to pay fees. It would seem that there has been a substantial mitigation of this situation in the United Kingdom by statutory intervention. Under Section 58 of the United Kingdom Patents Act a licensee is permitted to determine a license agreement by giving three months' notice upon the patent ceasing to be in force. This determination may be made notwithstanding anything to the contrary in the agreement. The provision was first introduced in the 1907 Act in a form which was slightly modified in 1949. The lack of extreme English cases since that time implies that use is made of it.

In the United States of America it has been established since 1933 that a final adjudication of invalidity of a licensed patent operates as an eviction from the license and terminating the licensee's obligation to continue royalty payments

<sup>14</sup> Supra note 27 (Chp. 2); ((1863) 10 M.L.C. 294)

<sup>15</sup> Supra note 35 (Chp. 2); ((1877) 2 A.C. 423)

after that date - Drackett Chemical Co. v. Chamberlain Co.<sup>16</sup>

If the English or United States approach was to be adopted a licensee would be able to terminate a license once the patent was no longer of any force. This would not only act as a release from an agreement for which no consideration was being provided, but it would also strike out the naked restraint of trade that the licensing agreement had become. Certainly, if a restraint of this type was entered de novo upon the patent losing force, it would not be upheld as being reasonable as between the parties.

Having taken matters this far a further question can be put: Why not give the licensee the same opportunity as others to challenge the validity of a patent? An answer that has often been suggested to this question is that it would be unfair to allow a licensee who gains special insights into the operation of an invention through having worked under license to take advantage of this position to challenge the validity of the patent. Put in a modified form, licensing of patents may be inhibited if patentees realise that the granting of licenses will bring users into a strong position to make a challenge on validity.

These answers are to be taken seriously because it would appear that they reflect the reality of many a licensing

<sup>16</sup> 63 F (2d.) 853, 855, 6th Circuit (1933).

agreement. On the basis of theory inspired by patent law, the answers are not in any way acceptable. A patent specification is addressed to someone skilled in the art involved. The description should be such as to allow the skilled person to carry out the invention. The claims should be fairly based on what is described. The invention as claimed, should be novel and lacking in obviousness, with the ordinary person skilled in the art to be the arbiter once more. Accordingly, the line that is impliedly taken by the above answers, is that it is dangerous to bring a person up to the level of one skilled in the art by granting a license because the patent is less than what it purports to be and could not sustain the analysis of such a person.

There are further factors resting on the reality of many a potential licensee's position that give the issue a different complexion. There is no way that a person can legitimately work a patented invention without being licensed. Despite the title, a patent may have latent flaws that will be revealed only upon working it and short of facing an infringement action while engaged in a thorough testing, there is no way the information may be gained without taking a license.

The United States Supreme Court in Lear v. Adkins indicated awareness of the knowledge and interests of licensees when coming to the view that it was desirable in the public interest for any potentially invalid patents to be subject to challenge. It noted that if there were to be challenges, one



of the best sources would be licensees. The conclusion reached was that it could not be in the public interest to eliminate such a source.

Supposing one reached the conclusion that, on the grounds of public interest a licensee should be permitted to challenge the validity of a patent. Suppose also, that if a patent ceases to be in force, through any cause, a licensee may be permitted to terminate the licensing agreement. The question that emerges at the next stage is whether the licensee should be able to go back a further stage and avoid liability for any royalties due before termination of the agreement or recover any royalties previously paid. In essence, this was the question that had to be resolved in the 1805 case of Taylor v. Hare.<sup>17</sup> The court in that case, answered the question in the negative. Have there been sufficient changes in attitude to notions of consideration and of public interest factors to reasonably suggest a different result?

Much of the defence argument in Taylor v. Hare rested on arguing a failure of consideration. Taking consideration alone, it can still be argued that the virtual total failure of consideration in the licensing agreement is demonstrated when the patent is declared invalid. It can be said, quite reasonably, that any consideration lay in a valid patent and it is immaterial that the lack of consideration was not established from

<sup>17</sup> *Supra* note 6

the start. That is, anyone could use the subject matter of the patent from its inception and hence no consideration was provided by permitting use under license. The fact that the license provided a defence to any infringement action that the patentee could bring should not be accepted as providing consideration because a promise to refrain from bringing an empty action should never provide consideration.

There does not appear to be any satisfactory answer to these arguments on an analysis of consideration alone. Probably this arises through the law on consideration being fairly incoherent at the best of times and it being used more as a rationale than a full reason in awkward cases where no other basis can be invoked to gain a just result. The act of drawing to a licensee's attention the possibility of working in the area of the patent might evoke a favourable emotional response but only if the work had proved profitable. Similarly, provision of the shelter from additional competition that the patent tended to give to the licensee can be pointed to as providing consideration. The frequently drawn analogy between the patentee and licensee relationship and the relationship of landlord and tenant gives a ring of respect to this approach. Although emotionally satisfying, the analogy does not withstand analysis. The only landlord and tenant analogy that in any way approaches that of patentee - licensee of an invalid patent is one where the tenant is leased public land and, one could fancifully suppose, has no say in whether others use

his crops for cattle fodder, grow competing crops in his fallow land and sleep in his bed when the inclination moves them. This would clearly amount to an "eviction" on the landlord and tenant analogy. In competition terms in the patentee - licensee relationship, the hovering of potential competitors with there being no barrier to market entry provided by a valid patent can press matters to the stage of de facto eviction in that one is returned to the non-privileged status.

An argument that is not directly put in consideration terms but is affiliated with notions of consideration is one that can be mounted on grounds of avoiding unfairness. Unfairness could emerge through a licensee making a fairly effortless entry to the market whilst working under the license and then ridding himself of financial obligations to the patentee once he was appropriately established. Related to this is the unfairness to a patentee who has calculated a return over the normal patent term and who gains only a small part of this return when the patent is successfully challenged by a licensee who pays royalties only for the time required to establish himself in the market.

The defect in the argument resting on unfairness is that its focus is on the near-free ride that can be taken by a licensee with the tacit assumption that the patentee should be fully recompensed to avoid this result. The line of thinking pushes into the background the crucial factor that the patent is invalid - if it



was not the royalties would be payable and the problem would not arise. No doubt some sympathy is due to the person who conscientiously applies time and money to acquiring a patent that turns out to be invalid but this is a problem shared by the holders of the 80% and upwards of the patents, valid and invalid, that earn no direct rewards. Accent on unfairness, if carried through, would achieve the result of the holder of an invalid patent receiving royalties that cannot be regarded as fairly due to him. Rather than allowing the patentee to be the beneficiary, the result that should be sought should be merely to limit possible freeloading by the licensee. As the freeloading will occur only through the licensee carrying out something that the public may temporarily regard as protected, there should either be a payment into the public sector or alternatively, and more realistically from a management point of view, there should be some incentive for the licensee to expose the invalidity of the patent as soon as possible.

It was by taking into account the incentive for a licensee to act in a way that may benefit the public interest that led to the conclusion reached in the United States case of Troxel Manufacturing Co. v. Schwinn Bicycle Company.<sup>18</sup> In this case, the plaintiff as a licensee of a patent held by the defendant, had paid royalties until the United States District Court had found the patent invalid. Later, the 9th Circuit had confirmed the District Court's finding of invalidity. The plaintiff brought the

<sup>18</sup> 465 F. (2d.) 1253, 6th Circuit (1972); U.S. cert. denied 416 U.S. 939

action to recover all the royalties that he had paid. The defendant brought a counter claim for royalties for the period between the District Court's finding and the confirmation of that finding.

The argument put by the plaintiff was that the impact of Lear v. Adkins was to wipe out all licensee estoppel and as any resistance to a return of royalties could be based only on a consequence of the estoppel doctrine recovery should be permitted now that the doctrine had been discarded. The court analysed the reasoning on which the Supreme Court had based its Lear v. Adkins decision and considered the impact that this may have had on the longstanding decision of Drackett Chemical Co. v. Chamberlain Co.<sup>19</sup> Drackett had decided that a licensee's obligations to pay royalties came to an end when eviction occurred through an adjudication of invalidity of a patent, but also decided that there was no right to recoup royalties paid before the eviction. Drackett had heeded the estoppel rule and would not have permitted the licensee to challenge. That aspect could no longer be good law, but did Lear overrule the prohibition on recouping royalties previously paid? The 6th Circuit was of the view that it did not.

The decision in Lear v. Adkins was based on giving heavy weight to public policy aspects of patents and determining that the muzzling of licensees was not desirable.

<sup>19</sup> 63 F (2d.) 853, 6th Circuit (1933)

On this basis, the court in Troxel's case attempted to determine what rule would act as the best incentive to "unmuzzling". It was thought that if back royalties could be recovered, it would be within the interests of a licensee to defer challenging validity in the hope that another party may make a challenge or, if no other challenge was forthcoming, make a challenge towards the end of the patent period when the possibility of a successful infringement action could do less harm to the licensee. Hence, an extension of the Lear case by allowing recovery of back royalties would run contrary to the spirit of Lear by providing no stimulus to an early challenge. When account was taken of the possible disincentive that a potential return of all royalties (with the consequential loss of certainty) would provide on patentees granting licenses, the public interest factors were seen as weighing against Lear being so interpreted.

With respect to inequities that the District Court sought to avoid by ruling that repayment should be made, the view was expressed that in the absence of fraud or misconduct by the patentee, it would be more inequitable for a patentee to make such a return given the uncertainty of the patent system.

The upshot of these deliberations was that the plaintiff - licensee could not recover back royalties and nor could the patentee bring action for amount outstanding since royalty payments ceased in that this could only be recovered by an



infringement action to which the licensee would have a ready defence.

The conclusion reached in Troxel v. Schwinn is attractive for a reason that did not have to enter the court's deliberations. A difficult problem could arise if a patent was challenged and it was held that only some of the broader claims were invalid. If recovery of all past royalties was permitted, this could lead to real injustice to the patentee as much of the activity under the patent could fall within claims that were upheld. With the licensee being in the position to terminate the agreement and, if needs be, face an infringement action, there would be an opportunity to determine the extent to which the licensee's activities fell within the subsisting claims. Probably this action could be avoided and, assuming that the parties are still capable of negotiations (this is probably assuming that the licensee was not the instigator of the challenge) a new licensing arrangement may be evolved.

There is also a possibility of adapting the Troxel v. Schwinn approach so that it would be in accord with the main thrust of the decision of the English Court of Appeal in Lyle Meller v. A. Lewis et al. This case was previously discussed in the context of a licensee challenging the scope of the patent.<sup>20</sup> The majority of the Court of Appeal adopted the common law rule of estoppel to preclude the licensee from arguing

<sup>20</sup> Supra note 87, Chapter 2.

that he was operating outside the scope of the patent when he had entered a second agreement to settle a dispute that had arisen. Denning L.J. came to the same conclusion by applying equitable or quasi-estoppel of High Trees origin. It would seem that the same line of reasoning that is illustrated in Lyle Meller would not permit recovery of back royalties. If notice was given of termination by the licensee, there would be no objections from this quarter save the residual one of licensee estoppel which still lingers.

With the dominance given in Lear v. Adkins to the public policy interest in subjecting doubtful patents to challenge it would be expected that specific clauses in licensing agreements that purported to prevent challenge by a licensee would be put aside by the courts. Indeed, this was done very shortly afterwards in Massillon - Cleveland - Akron Sign Co. v. Golden State Advertising Co.<sup>21</sup> and this approach was followed even with respect to agreements emerging from settlement of infringement contests in Business Forms Furnishing Service Inc. v. Carson<sup>22</sup> and with respect to a consent decree in Butterfield v. Oculus Contact Lens Co.<sup>23</sup>

The Butterfield type of extension to opportunities to question validity was not permitted by the United States Court of Appeals, 6th Circuit in Schlegel Manufacturing Company v. U.S.M. Corporation.<sup>24</sup> In this case it was held that the doctrine of res

<sup>21</sup> 444 F (2d.) 425, 9th Circuit (1971)

<sup>22</sup> 452 F (2d.) 70, 7th Circuit (1971)

<sup>23</sup> 332 F Supp. 750, N.D. Illinois E.D. (1971)

<sup>24</sup> 525 F (2d.) 775, 6th Circuit (1975)

judicata should not give way, in the circumstances of the case, to the public policy interests expressed in Lear v. Adkins. A consent decree entered in an infringement action where the validity of the patent had been accepted, was held to be such as to prevent re-opening the question of validity in an action for contempt of the decree. An appeal to the Supreme Court is still pending, but regardless of the result, a far more significant public policy factor than yesteryear's common law contract rules are at issue in this case.

There do not appear to be sufficient differences between the Canadian and United States positions to warrant the difference that is current on the licensee estoppel issue save the fact that Canadian courts are less willing to contemplate the effects of their decisions. Legislative intervention is probably necessary to resolve the matter. In the absence of any reform, the anomolous situation will arise that United States patentees through their Canadian patents, will be able to enjoy far more advantageous positions with Canadian licensees than what may be enjoyed in the United States of America. The situation could readily arise that a successful challenge to the validity of the parent United States patent could be of no relevance to a Canadian licensee who would be bound to maintain royalty payments. Whilst this may have no bearing from a narrow legal outlook, its policy ramifications speak for itself.



### 3. Estoppel arising from Patent Assignments

The assignee of a patent does not have anything in the way of a restraint of trade placed on him by dint of the normal assignment agreement. Should an action by an outsider demonstrate that the patent was invalid, an assignee's concern will be the poor bargain that he has contracted for, a bargain that may be so poor that it amounts to virtually a total failure of consideration. Perhaps validity could be challenged by an assignee through there being a specific provision in the assignment agreement making validity a condition (seemingly, a virtually unheard-of provision) or through the law being modified to make validity either an implied term or, what amounts to the same thing, a necessary element to provide consideration. If the way for a challenge was made clear, however, the only reason that the challenge would be made would be as a base for an action to recover some part of the amount paid for the patent and/or damages. The lack of any restraint placed on an assignee makes it difficult to match it with the situation of a licensee.

Despite the lack of restraint on an assignee, it would still be possible to mount a public interest argument in favour of permitting the assignee to challenge validity. Such an argument would rest on the Lear v. Adkins approach of promoting the public interest by unmuzzling all potential challengers. Unfortunately for ease in argument, this approach meets an early

set-back from the same type of considerations as those motivating the court in Troxel v. Schwinn. If a licensee should not be permitted to recover royalty payments because such a right would tend to dissuade rather than encourage an early challenge, how can a system be designed to bring about an early challenge by an assignee? Clearly it would be highly undesirable to permit an assignee to gird himself with a patent which may intimidate many potential users and then let him bring an action against the assignor when he or another demonstrates the invalidity of the patent towards the end of its term. This overlooks any statutory limitation periods that may apply, but even within such periods the anomalies would become apparent. There would be anomalies of another nature, however, if an assignee was to be given a very limited time in which to bring a challenge on validity and make a recovery from the assignor. These anomalies would arise through the fact that any flaws that a patent may have often become exposed only when it is playing a significant role in the market and the time taken for a patent to attain commercial maturity can vary greatly.

The above problems have high significance in that, short of some extraordinary measure, such as offering a bounty to every successful challenger of a patent, there would be no point in a public policy decision in favour of permitting an assignee to challenge validity unless challenges were encouraged by a coherent set of legal devices that were sufficient fail-safe to avoid frequent defeat of the public policy objects. The problems

are also significant in that some match will have to be made between remedies that may be available to assignees and those available to assignors. The policy implications on possible changes to the assignor estoppel doctrine will be reviewed before discussing assignee estoppel any further.

It will be recalled from the last chapter that assignor estoppel had its origins in the courts refusing to permit one to derogate from his own grant. This can be quite an artificial motive for the rule when the grant is not a deliberate act but has occurred through an assignment by an employee to his employer under his contract of employment or occurs as an incidental aspect of transfer of partnership property upon dissolution of a partnership.

The restraint of trade implications of assignor estoppel arise through an assignor not having the defence that others would have to an infringement action brought on activities that fall within the scope of what will be assumed to be an invalid patent. Such a restraint is much more likely to be categorised as reasonable as between the parties than the restraint that applies through licensee estoppel. In many circumstances the assignor will be more aware of the strengths and weaknesses of the patent than a licensee and a payment will have been received by the assignor for transferring the patent. An assignor is often in a similar situation to a vendor of the goodwill of a business and the arguments that have been



accepted in restraint of trade cases in support of constraints on the vendor of goodwill can find application in patent assignments. It is because of this ready analogy that "no derogation from his grant" is reasonably appropriate. The balancing of reasonableness as between the parties becomes a different sort of exercise in the situations mentioned above where there is not any real discretion available to the assignor in making the grant.

Reasonableness as between the parties could be dubious in circumstances where an employee is instructed to take out a patent. If one had an extreme situation where, say, an employer instructs an employee to make application for a patent despite the employee's protests that the subject matter lacks novelty, it could be a most unreasonable restraint on the employee after he has left the employer for him to be bound not to use the subject matter of the patent. Similarly, if one views matters along the lines of fairness to each party there may be no fairness involved in prohibiting an assignor from "derogating from his grant" by exposing a flaw in a patent which was well known by the assignee at the time of the assignment.

Taking the problem from a different angle, it would be unreasonable as between the parties and contrary to notions of fairness if an assignor, after receiving generous payment, was permitted to bring to light a source of invalidity that happened to be completely concealed from the assignee. This may be something along the lines of prior use of an invalidating nature that the assignor had engaged in before applying for the patent.

Virtually regardless of the different results that may emerge on reasonableness as between parties according to the nature of the assignment and nature of the source of invalidity, the public interest factor remains virtually constant. On the considerations regarded as material in Lear v. Adkins any exposure of patent invalidity is to be encouraged in order to release the subject matter of the patent to public use. As there are no advantages in the assignor deferring a challenge of validity, the Troxel v. Schwinn considerations have no application. Whereas exposure of sources of invalidity known by the assignor only makes this a hard case on reasonableness as between the parties the public interest considerations would seek to promote anything along the lines of a confession and repentance by the assignor.

There is one public interest factor, however, that tends to push matters in the other direction. This is the factor that is also found in situations of sale of goodwill. If an assignor is permitted to strip a patent of its validity, it will tend to reduce the price that can be asked by patent holders because greater uncertainty is introduced. Such a price reduction would reduce the incentive for patentees to transfer their rights to persons better able to exploit the subject matter of a patent and, in turn, may reduce incentives for patents to be sought. These considerations apply in a modified way, to licensing of patents as well but the all or nothing implications of assignments gives

them more impact in this regard.

Despite these differences between assignor estoppel and licensee estoppel, the Lear v. Adkins ruling was applied by the 9th Circuit in Coastal Dynamics Corp. v. Symbolic Display Inc.<sup>25</sup> The matters taken into account by the court in that case are not known in that the only comment made was "We are not persuaded that assignor estoppel requires any different rule (than in Lear v. Adkins)."

Doing away with assignor estoppel will provide little satisfaction for assignees unless there is an adaption of the statement made as an aside in Troxel v. Schwinn. It was mentioned in that case that a licensee may be in the position to recover previously paid royalties if there had been fraud or misconduct by the patentee.<sup>26</sup> If these things were shown recovery by the assignee may be appropriate. Full recovery may be difficult in practice, as is often the case where misrepresentations enter contractual matters, but this would give at least a potential remedy to the assignee. The alternative of not permitting any exposure of such matters presses an assignee into the unsavory position of perpetuating fraud or misconduct to the expense of the public rather than suffering any individual loss.

If potential invalidity of a patent arises

<sup>25</sup> 469 F (2d.) 79 (1972)

<sup>26</sup> 465 F (2d.) 1253, 1259



through something short of fraud or misconduct, it is not easy to find a satisfactory answer to the party to party conflict in the traditional field of contracts. By analogy with what has been generally referred to as the "common mistake" cases in contracts one could use the alternatives of possible implied terms as outlined by the High Court of Australia in McRae v. Commonwealth Disposals Commission.<sup>27</sup> In construction of an agreement of assignment one might say either that it was implied that:

- (a) it was a condition precedent that the patent be valid;
- (b) it was a condition of the contract that the patent be valid;
- (c) the purchase involved a mere chance on whether the patent was valid or not.

The only realistic choices here would seem to be (a) and (c) as, given the well known uncertainties in patent validity, it is most unlikely that an assignor would willingly lay himself open to liability for damages if the patent should be invalid. This is because the expenditure that may be necessary to carry out an invention can be massive and it is probably because of this that the patentee is not directly exploiting the invention on his own.

The alternative (c), the "mere chance", in effect reflects the current position. Abolition of assignor estoppel would be doing no more than saying that, absent fraud,

<sup>27</sup> (1951) 84 C.L.R. 377

the "chance" should be subject to further assessment by the assignor in the same way that other interested parties may make a reassessment after neglecting to take the opportunity to bring Opposition proceedings that are permitted under the United Kingdom Patents Act.<sup>28</sup>

The condition precedent, alternative (a), has attractions because it would provide a remedy to the assignee if the assignor challenged. On the public interest aspects for assignee challenges, there would be the problems outlined earlier in inducing an early challenge. Also from the public interest aspect, it would tend to discourage an assignor. None of these issues will have any real impact, however, in the assignments from employee to employer, etc. With this category of "hard cases" it is immaterial from a practical viewpoint as to whether alternative (c) or this alternative (a) is selected.

The conclusion that emerges from the above analysis is that public interest considerations favour setting aside the doctrine of assignor estoppel but, unless limited, yet sufficient time constraints could be introduced, the public interest factors would weigh against introducing an implied condition precedent of validity of the patent. With no such condition proof of invalidity by an assignee would be irrelevant and so no change would in fact take place in the assignee estoppel rule.

<sup>28</sup> Section 14; the Conflict proceedings under the Canadian Act do not give the same opportunity to oppose an application. A form of the current United Kingdom provisions have existed since 1883 and if this factor had been considered earlier, it possibly would have affected Canadian law.

CHAPTER FOUR1. Introduction

Patents are often licensed as part of a package of patents, trade secrets and know how. If the patent or patents involved happen to be invalid, say through lack of novelty, there will be no relief to the licensee as matters stand at the moment in Canada and the United Kingdom because of the estoppel doctrine. Should the estoppel doctrine be put aside there will be potential relief for some licensees and hence an incentive to challenge validity, but often little relief for those who received what were said to be trade secrets along with the patent license. Upon termination of the patent license the trade secrets will live on and possibly the activities of the licensee will be brought to an end despite the theoretical freedom that he now has to work the subject matter of the patent. The nature of trade secrets and the possible legal remedies available to restrain their unauthorised use becomes a significant issue.

There will be often instances where trade secrets will be in use without their being directly associated with any patents. If a trade secret is in the custody of one person, as with say, the alchemist of earlier times, there can be no legal complications. It would be a most unusual situation nowadays for there to be a sole holder of a trade secret and so the law will



become involved in determining the obligations owed to the initial holder of the trade secret by those to whom the secret is revealed. Such persons can include employees, subcontractors and persons to whom the secret has been revealed in confidence.

A major difference between a valid patent and a trade secret is that no one is permitted to make an unauthorised use of the subject matter of a patent whereas with a trade secret anyone who independently discovers the secret is free to use it. Therefore, a patent monopoly provides a much more embracing protection for a patent owner than does a trade secret. A patent, however, has only a limited life whereas some trade secrets can run for a lengthy, indeterminant time.

Some trade secrets could not qualify as patents if application were made because they are not eligible subject matters for patents. There are other trade secrets that fall within the class of eligible subject matter but would not qualify as patents because they lack the necessary novelty or lack of obviousness required in a patent. It is on this latter group that concentration needs be centred in that if a process or product is not worthy of recognition as a patent, presumably it should not acquire protection to the level accorded to patents.

On occasions a trade secret would be able to qualify as a patent but the holder is of the view that it is not readily susceptible to discovery by reverse engineering or independent research and decides to refrain from making it the subject of a patent application. By this decision the holder of a

trade secret is avoiding making a grant to the public domain of the subject matter of his secret at the end of a fixed term of monopoly. As this public grant is a basic quid pro quo for the patent monopoly it would seem anomolous if a trade secret holder was permitted remedies that gave the protection of the secret a status close to the protection of a patent.

A useful exercise would be to set out a description of what constituted a trade secret, the obligations placed on a person in whom a trade secret was entrusted and the remedies available should these obligations be unmet. This has been attempted in the past.<sup>1</sup> In this instance a reciting of the law is not to be attempted as such in that the accent is to be placed on isolating the major factors that run into conflict in the trade secret area.

The unpredictable character of trade secret law today arises from problems of determining questions of fact and law. These mixed issues are common in quite a number of areas of law but in this area the problem appears more acute than most. The problems in determining what constitutes novelty or lack of obviousness in the patent field are much more straight-forward than the problems of determining what constitutes a trade secret. One has in the

<sup>1</sup> See A.E. Turner "The Law of Trade Secrets" Sweet & Maxwell 1962 and the 1968 Supplement and very much second, Aaron N. Wise, "Trade Secrets and Knowhow Throughout the World" Clark Boardman Company Ltd., 1974, Volume 2 in particular.

trade secret area not only the complications that can arise in applying the law to a wide range of highly technical material but also a singular lack of precision in definition of the law itself. There have been broadly stated guidelines laid down by the courts with each one having its problems in application. Where the difficulties are compounded is through the various guidelines overlapping and at times clashing badly through having been developed with different interests being given prominence.

The object of this Chapter is to present a broad outline of the nature of trade secrets, indicate the unusual way in which the basic rules emerged and attempting to isolate the interests favoured in the various rules. The compatibility or otherwise of the rationale for these rules with policies implied in other areas of law are to be examined with special attention being given to competition law and patent law.

## 2. The Nature of Trade Secrets.

A trade secret cannot be something that is generally known. This much is undisputed and there seems little dispute that it is possible for more than one enterprise to be using a technique that each one has evolved independently and that technique can maintain the trade secret categorisation. It is also accepted that once the technique is nearly universally known in a sector of industry to which it can be applied, it is no longer a trade secret. There has been no known attempt to draw a line of



demarcation between these extremes.

A guideline that has been frequently used, albeit in a negative fashion, is to examine the extent to which efforts have been made by the holder of the trade secret to maintain its security. If there is limited access to the area where the process is carried out with security precautions giving the appearance that it is the process rather than just ordinary property that is being protected then this may be persuasive in demonstrating that the process is secret.<sup>2</sup> Lack of this indicator can be fatal.<sup>3</sup> This indicator alone has, most sensibly, never been taken as conclusive.<sup>4</sup>

Publication in a publicly available document of the nature of a trade secret is the antithesis of maintaining tight security and one would therefore expect publication to be fatal to the secret. In O. Mustad & Son v. Dosen and S. Allcock & Co. Ltd.<sup>5</sup> a 1928 decision of the House of Lords first reported in 1963, it was held that disclosure by the plaintiff in a patent specification had terminated secrecy. Publication in a Belgian patent specification that became available in the United Kingdom Patent Office library was held to have robbed the information of its confidential status

<sup>2</sup> Amber Size & Chemical Co. Ltd. v. Menzel (1913) 30 R.P.C. 433.

<sup>3</sup> Robin-Nodwell Mfg. Ltd. v. Foremost Developments Ltd. and Nodwell (1966) 52 C.P.R. 244; and Wilson Certified Foods Inc. v. Fairbury Food Products, 370 F. Suppl. 1081 (1974).

<sup>4</sup> See Houser v. Snap-On Tools 202 F. Supp. 181 (D.C.Md. 1962) for rejection of a "hollow confidence".

<sup>5</sup> [1963] R.P.C. 41; [1964] 1 W.L.R. 109

in the United Kingdom in the case of Franchi v. Franchi.<sup>6</sup>

These decisions, in effect, follow the same line as in the patent field where publication in any publicly available document can constitute an anticipation of a patent application. However, in the trade secret field no absolute rule emerges. In Cranleigh Precision Engineering Ltd. v. Bryant<sup>7</sup> knowledge of a published patent specification was held to be information that had to be kept in confidence.

Whether disclosure in a publication should be accepted as a trade secret involves a significant value judgment. It amounts to a question of accepting a theoretical or practical view on the accessibility of the appropriate knowledge. In the patent law field the theoretical view is taken - if something has been published it is assumed that all interested parties had or could have had access to it. In the trade secret field there has been pressure to have classified as trade secrets even material that has been published.<sup>8</sup> The basis of the argument is that, in practice, it can cost a great deal of money to separate the appropriate needles of really useful information from the haystack of technological literature and once the needles have been identified this should be worthy of protection.

The above argument is really an application of another guideline that is frequently invoked: did it cost a good deal of time and money to acquire the information for which trade secret status is being claimed? This guideline first appeared to be

<sup>6</sup> [1967] R.P.C. 149

<sup>7</sup> [1965] 1 W.L.R. 1293; [1964] 3 All E.R. 289

<sup>8</sup> See for example, remarks by Tom Arnold "Shadows do not Fight" in "Protecting Trade Secrets Today" Practising Law Institute 1973, pp.25-28

given weight in cases involving the gathering of news,<sup>9</sup> information for a trade directory<sup>10</sup> and a host of customer list cases. The need for such a test is clear in these cases because it could seldom be claimed that much of the information was not available in some published form or other and nor could it be claimed that it had any element of discovery or novelty. It does seem to find service, however, in technically orientated fields where these other facts are being argued as well.<sup>11</sup> The possible rebuttal to a time and money argument could be that expenditure was necessary only because of initial technological backwardness but no case has been found where this has been argued specifically.

The lack of expenditure of time and money on isolating information need not prove fatal to a trade secret classification because a brilliant but cost-free insight can qualify. This entails an element of "discovery" which is an ingredient that courts have at times stated to be essential in technical fields.<sup>12</sup> Although this "discovery" element is at times demanded, what is universally accepted is that one does not require novelty to the standard required in the patent field. This point was directly at issue in Sandlin et al v. Johnson<sup>13</sup> because the court specifically

<sup>9</sup> Exchange Telegraph Company Ltd. v. Gregory & Co. [1896] 1 Q.B. 147

<sup>10</sup> Lamb v. Evans [1893] 1 Ch. 218

<sup>11</sup> Ansell Rubber Co. Pty. Ltd. v. Allied Rubber Ind. Pty. Ltd. [1967] V.R. 37, 49

<sup>12</sup> See especially Sarkes Tarzian Inc. v. Audio Devices Inc. 166 F. Supp. 250 (S.D. Cal. 1958)

<sup>13</sup> 141 F (2d.) 660 (8th Circuit 1944)



ruled as erroneous the District Court's conclusion that no obligation of confidentiality had been breached because the discovery did not constitute a patentable invention. This view has been generally accepted inside and outside the United States of America.<sup>14</sup> At times the term novelty is said to be necessary, but such references are in the context of distinguishing the information from that which is generally known rather than putting it at the patent level of novelty, or lack of obviousness.

A guideline that tends to embrace the other guidelines is to determine whether the information was of value to competitors. This approach emerged in the colourful form of the "springboard" doctrine of Saltman Engineering Co. Ltd. v. Campbell Engineering Co. Ltd.<sup>15</sup> a case virtually forgotten until given an uplift in Peter Pan Manufacturing Corp. v. Corsets Silhouette Ltd.<sup>16</sup> The springboard doctrine has been the main guideline used in Brian D. Collins (Engineers) Ltd. v. Charles Roberts & Co. Ltd.<sup>17</sup> Suhner & Co. A.G. v. Transradio Ltd.,<sup>18</sup> Terrapin Ltd. v. Builders' Supply (Co.) Hayes Ltd.<sup>19</sup> and Seager v. Copydex Ltd.<sup>20</sup>

<sup>14</sup> Adopted in The Restatement of the Law of Torts, art 757 which has been widely favourably noted - see for example Ansell Rubber Co. Pty. Ltd. supra note 11, p.50

<sup>15</sup> (1948) 65 R.P.C. 203; [1963] 3 All E.R. 413

<sup>16</sup> [1963] R.P.C. 45; [1963] 3 All E.R. 402

<sup>17</sup> [1965] R.P.C. 429

<sup>18</sup> [1967] R.P.C. 329

<sup>19</sup> [1967] R.P.C. 375

<sup>20</sup> [1967] R.P.C. 349; [1967] 2 All E.R. 415

The basis of the springboard doctrine is to enquire whether the information that has been or may shortly be transferred in an unauthorised fashion is such as to advance the interests of the outside person. Where it tends to do the same service as the other guidelines is that if the information is generally available or would require little effort to acquire independently then it would not be such as to make an unauthorised transfer any real advantage. If the information is found to provide a springboard for the competitor then it should be classified as a trade secret and the restrictions placed on transfer of trade secrets should apply.

The springboard test has a good deal in common with the definition of trade secret set out in the Restatement of the Law of Torts,<sup>21</sup> the principal sentence of which reads:

"A trade secret may consist of any formula, pattern device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it."

In the 1965 Supplement to the Restatement there are over fifty cases listed in which the above statement had been used in support. It is still frequently invoked in the United States of America and it has also been noted in English and Australian cases.

The Restatement does later mention that secrecy is an essential aspect to a trade secret but in noting that novelty

<sup>21</sup> American Law Institute, 1939, s.757, Comment (b).

and invention are not required it does not go further and indicate whether an element of discovery is necessary.

The major difficulty to be found in the springboard or the Restatement approach is that it really begs the question. If information passes or is about to pass to a competitor and the information holder does not favour this, all he need do is demonstrate that the information may be useful to the competitor. By application alone of the springboard or Restatement approach a trade secret categorisation is given to such information. Even at first impression this covers information that one might expect to be outside any legal impediments to free flow. The reason for the unexpected width of the definitions is that neither provides a definition at all but instead provides a description of some of the characteristics of trade secrets. The use of these approaches alone can give results as misleading as say, "defining" a cow as a four-legged mammal. Unfortunately, this appears to have been overlooked in many cases.

Two limitations should be put to the springboard or Restatement descriptions of trade secrets from the outset. Both are well recognised although difficulties have been experienced in their application. The first limitation is that trade secrets do not embrace information that is to be found as part of the ordinary skill, knowledge and experience of an employee. The



The second limitation relates to the care which should be exercised in determining what an "unauthorised" divulgence of a trade secret constitutes if trade secret is given a wide description. These limitations overlap in some circumstances.

The following illustration may clarify the position. Suppose the proprietor of a highly-regarded restaurant had in his employ a talented chef who during the course of his employment perfected a recipe for a sauce that gave the restaurant even greater fame. Information on the secret of this sauce would be much sought after by competitors and the proprietor of the restaurant would very much prefer to keep this information exclusively his. On a springboard or Restatement approach the recipe qualifies as a trade secret. Can the chef reveal it to a competitor or apply the recipe in the service of a competing restaurant? It would seem that knowledge of the recipe would be part of the skill and knowledge of the chef so possibly he can apply it elsewhere. However, perhaps there should be some bar to the chef selling the recipe to a competitor for a large sum whilst continuing work in the same restaurant. If this be the case, it would be due to the divulgence of the secret being unauthorised. The situation can be complicated further if one considers the position of another chef in the same restaurant, the meat chef, who through working side by side with the sauce chef, comes to know the secret recipe.

The personal skill and knowledge of this chef possibly would not embrace the recipe and possibly there will also be a difference in what he may be authorised to reveal.

The scope given to "the personal skill, knowledge and experience" of an employee is critical to the law of trade secrets. It is true that it has little relevance to cases where a trade secret is revealed in confidence without there being any contractual relationship between the parties, but such cases are very rare by comparison with those involving an express or implied condition to refrain from revealing trade secrets in contracts of employment. In these cases, and in the closely analogous cases of subcontracting arrangements, the personal attributes of an employee act to limit the material that can be classified as trade secrets.

Recognition of the need to permit an employee to carry "personal" knowledge with him upon termination of his contract of employment is long established.<sup>22</sup> What has become more difficult is determining what falls within its scope. The major cases of yesteryear involved matters of little technical sophistication with employees being tradesmen or craftsmen. Many modern cases involve very complicated technologies. Therefore, the decision making has shifted from determining the ordinary skill, knowledge and experience of a plumber or electrician to determining

<sup>22</sup> Robb v. Green [1895] 2 Q.B. 1; Morris v. Saxelby [1916] 1 A.C. 688; Attwood v. Lamont [1920] 3 K.B. 571.

that of a research chemist with three years post-doctoral experience in a University before moving to ten years of employment in pharmaceutical research. Such a person starts employment with a vast amount of skill and knowledge but a return to that starting position would be near impossible and certainly highly undesirable even if it were possible.

The problems of definition are great. This leads to uncertainty in the law of trade secrets. Greater uncertainty arises however, through the frequent disregard of the clash of interests involved. A bias towards employer interests is implicit when matters are viewed along the lines of the American Restatement or the springboard doctrine. The personal skill of employees is often noted as a minor exception that can provide difficulties in various cases and in the many articles written with this bias. On the other side, there are cases that give quite a wide scope to personal skills and these cases, with the accent being given to employee mobility, partially reflect a bias towards employee interests whilst mainly favouring freedom of competition. Accordingly, they tend to be depicted as restraint of trade cases with the unsuccessful trade secret argument being given a low profile.

Another interest that is often said to be favoured by the law of trade secrets is that of fair dealing and good faith. Hence, emotive terms such as "industrial espionage", "stealing" and "filching" are employed when mentioning the unauthorised transfer of trade secrets. There are probably established legal remedies available against activities that can be aptly described in



this way without a separate "trade secret" law being necessary. What modern trade secret law often tends to do is place a restraint on employee mobility with a resultant stemming of technology transfer when none of the emotive terms could reasonably be applied.

The early development of trade secret law will now be examined, followed by a tracing of early developments in restraint of trade law.

### 3. Evolution of Trade Secret Law.

Cases that were directly related to trade secrets in the modern sense did not occur until the end of the nineteenth and beginning of the twentieth century. The authorities relied on in these cases were mainly concerned with material being used for purposes other than that for which it had been provided. Most of them hinged on matters that would be readily resolved by present day copyright legislation. Accordingly, they are more copyright cases than trade secret cases but the limited scope of copyright legislation of the time led to some statements of principle being made that were adapted to the trade secret area. A re-examination of these earlier cases is of interest because the principles stated in them were often expressly or impliedly limited in manners that were overlooked later.

Use of a manuscript in an unauthorised manner was enjoined in Duke of Queensberry v. Shebbeare.<sup>23</sup> This is quite

<sup>23</sup> (1758) 2 Eden 329; 28 E.R. 924.

clearly a precursor to modern copyright law in that the defendant in this case was held to be acting outside the purpose for which an unpublished manuscript had been made available to him by his proposal to make multiple copies of the manuscript for his own profit.

Personal letters in the hands of recipients raised issues for the courts to resolve. In Thompson v. Stanhope<sup>24</sup> the executors of the estate of Lord Chesterfield were successful in gaining an injunction against the widow of the Earl's "natural" son to prevent publication for gain of correspondence between father and son. Before his death the father had requested the return of some of the correspondence because it may have caused embarrassment but the widow had kept copies. There was also what was purported to be imminent unauthorised publication of letters in a newspaper in the case of Lord and Lady Perceval v. Phipps<sup>25</sup> but at equity the injunction was dissolved with the parties left to any action they may have at law because the plaintiffs failed to provide any answer to the defendant's reply that publication was not for sake of profit but to vindicate the character of Lady Perceval's one time servant and that of the newspaper proprietor. An injunction against publication of letters of a personal nature was granted with great reluctance by Lord Chancellor Eldon in Gee v. Pritchard.<sup>26</sup> The ground selected for granting the injunction was that letters directed

<sup>24</sup> (1774) Amb. 737; 27 E.R. 476

<sup>25</sup> (1813) 2 V. & B. 19; 35 E.R. 225

<sup>26</sup> (1818) 2 Swan. 402; 36 E.R. 670

to yet another "natural" son of a member of the aristocracy lost any character they may have had as being the property of the defendant when he had, on request, returned them to the writer, an act that he performed only after meticulously taking copies.

Orally delivered lectures by a surgeon in the case of Abernathy v. Hutchinson<sup>27</sup> were not susceptible to protection under copyright but it was held by Lord Eldon that an injunction should be issued to restrain publication in a magazine of a shorthand writer's record of the lectures. This decision was based on a finding that the students attending the lectures were permitted to use the lecture material only for their own individual information and there was an implied contract that the material was not made available to them for publishing it for profit. Although the person responsible for taking the shorthand notes and transmitting them to the magazine publisher was not known the injunction would nonetheless lie against the publisher as the notes could reach him only through the breach of implied contract.

The case of Prince Albert v. Strange<sup>28</sup> was also a de facto copyright case. Private etchings that had been put in the defendant's hands for the purpose of making some duplications had been used to make further duplications which the defendant had announced would be featured in an exhibition where catalogues

<sup>27</sup> (1824) 1 H. & T.W 28; 3 L.J. (a.s.) (Ch.) 209; 47 All E.R. 1313

<sup>28</sup> (1850) 1 M. & G. 25; 41 E.R. 1171



containing reproductions and descriptions of the etchings would be for sale. The Lord Chancellor, Cottenham, in granting an injunction ruled that the author's property in the unpublished etchings provided sufficient grounds for an injunction but, if it had been necessary to decide he would have also found a ground for injunction on the basis that the catalogue, descriptions and further remarks could not have been obtained except for the surreptitious and improper making of additional impressions of the etchings. Similar facts were considered by the Court of Appeal in Tuck v. Priest<sup>29</sup> where a drawing had been placed in the hands of the defendant for the purpose of producing two thousand copies, but the defendant made additional copies which he later started to sell in competition with the plaintiff. The new Copyright Act<sup>30</sup> would have resolved this matter except that the reproducing had been performed before the copyright had been registered and hence the basis of the injunction granted was that the extra copies had been made in breach of contract and in breach of faith. Breach of an implied condition of the contract was also found in Pollard v. Photographic Co. Ltd.<sup>31</sup> when a professional photographer used the photograph of a paying client in a Christmas card.

The remarks made in the above cases relating to unauthorised acts of duplication were taken up in later years in

<sup>29</sup> (1887) 19 Q.B.D. 629

<sup>30</sup> 25 & 26 Vict. c. 68

<sup>31</sup> (1888) 40 Ch. D. 345

cases involved with trade secrets. What has tended to be overlooked in the later application of the dicta is that there might well be a need to distinguish the reproduction of material from taking and using the general subject matter. This is a distinction that is reflected in modern copyright legislation and one that was recognised shortly after the above cases.

The House of Lords in Caird v. Sime<sup>32</sup> followed a similar course to that taken in Abernathy v. Hutchinson<sup>33</sup> and held that a professor of a university who delivered orally his lectures to paying students did not communicate those lectures to the whole world so as to entitle any one to republish them without his permission. A distinction was made between republishing the lectures and using the teaching to be gained from them.<sup>34</sup> This theme was followed in Lamb v. Evans<sup>35</sup>. Here the defendants had worked on a commission basis for the plaintiff, collecting advertisements throughout Europe for publication in a trade directory to be used in England. Upon ceasing employment with the plaintiff, the defendants worked for a rival publisher where the subject headings and advertising blocks were in many instances reproduced for a rival directory. The lower court granted an injunction ordering that this activity cease but concluded the order by stating "order is not to extend to prevent the defendants or any of them making legitimate use of the plaintiff's work or any part thereof for the purpose of obtaining advertisements or otherwise."

<sup>32</sup> (1887) 12 App. Cas. 326

<sup>33</sup> Supra note 27

<sup>34</sup> Lord Halsbury, Ibid. 338

<sup>35</sup> (1893) 1 Ch. D. 218

When the Court of Appeal dismissed an appeal from the lower court it made no variation of this order. The basis of the order is open to debate, but doubts are resolved to an extent by the remarks of Kay L.J. where he said in reference to

Prince Albert v. Strange

"...I think the doctrine...does extend to every case in which a man has obtained materials (I use the word advisedly because it would be very difficult indeed to grant an injunction to prevent a man using his knowledge)..."<sup>36</sup>

This approach was also followed in Philip v. Pennell<sup>37</sup> where disputes arose as between the executrix of the artist Whistler and the defendants who had been given access to letters by the deceased artist in order to write his biography. It was held that the property of the letters remained with the author (executrix) and the initial receiver of the letters and hence, in the absence of any authorisation the letters could not be reproduced. However, it was also held that the letters could be used by the defendants to provide background information that may be of use in writing the biography.

It would therefore appear to emerge from the above cases that someone entrusted with material for one purpose was not permitted to make a reproduction of the material and use the reproductions for another purpose. Nothing is stated that suggests that an idea gained from the material could not be used and

<sup>36</sup> Ibid. p.236

<sup>37</sup> [1907] 2 Ch.D. 577



there are clear indications that such an extension was not contemplated.

There are other early cases relating to a different situation, a situation where material came into a persons hands in an unauthorised fashion.

In Yovatt v. Winyard<sup>38</sup> an injunction was granted to restrain the defendant from making use of or communicating certain recipes for medicines on the ground that he had obtained knowledge of the mode of preparing them by a breach of trust. The plaintiff who was the proprietor of the medicines, had employed the defendant as an assistant under terms that he was to be instructed the general knowledge of the business but was not to be taught the mode of composing the medicines. After the defendant had left the plaintiff's service, the plaintiff discovered that the defendant had surreptitiously gained access to his books of recipes and copied them and had commenced selling the medicines with instructions for administering them which were almost literal copies of the plaintiff's instructions.

The breach of duty in discovery of the secret was an important element in the Yovatt v. Winyard decision. Despite the brevity of the decision of Lord Eldon, Lord Chancellor this point emerges from the plaintiff's counsel readily conceding that a court might not protect a secret from disclosure by one to whom the proprietor had himself communicated it. The concession

<sup>38</sup> (1820) 1 Jac. & W. 394; 37 E.R. 425

was made in order to distinguish two earlier cases. Newbery v. James<sup>39</sup> and Williams v. Williams,<sup>40</sup> both decisions by Lord Eldon.

There was no unauthorised discovery of the secrets in Newbery v. James and Williams v. Williams. Both involved secret medicines with the relationship in Newbery v. James being one between inventor - manufacturer and distributor whilst in Williams v. Williams an agreement between father and son, where the son was to be prepared for being brought into his father's business and this led to the revelation of the secret.

The main factor motivating Lord Eldon in his refusal to continue injunctions was the difficulty he saw in enforcing any order if it had been desirable to grant an injunction in such matters. He contrasted secrets of this type from patents and took exception to the fact that one of the secret recipes in Newbery v. James had been the subject of a patent which had expired. Lord Eldon's remarks have an uncanny similarity to those of the Supreme Court of the United States of America over one hundred and fifty years later and hence are quoted here at some length.

In Newbery v. James<sup>41</sup>

"...the medicines in question were the subject of a patent which had expired; and the agreement which the bill sought to enforce was an agreement, by which, independently of the patent, the proprietors had entered into covenants not to sell that which was the subject of the patent, except to each

<sup>39</sup> (1817) 2 Mer. 446; 35 E.R. 1011

<sup>40</sup> (1817) 3 Mer. 157; 36 E.R. 61

<sup>41</sup> (1817) 2 Mer. 446, 451

other. But in order to support a patent, the specification should be so clear as to enable all the world to use the invention as soon as the term for which it has been granted is at an end. Then, with regard to the Analeptic pills, for which no patent had been procured, if the art and method of preparing them were a secret, what signified an injunction, the Court possessing no means of determining on any occasion whether it had or had not been violated?'

(Lord Eldon concluded by stating that the parties may care to try their action at common law if any remedy could be found there, but he would grant no injunction.)

In Williams v. Williams, a firmer line.<sup>42</sup>

"But so far as the injunction goes to restrain the Defendant from communicating the secret, upon general principles, I do not think that the Court ought to struggle to protect this sort of secrets in medicine (see Newberry [sic] v. James...) The Court is bound indeed to protect them in cases of patents, to the full extent of what was intended by the grant of the patent, because the patentee is a purchaser from the public; and bound to communicate his secret to the public at the expiration of the patent. Then, whether the principle can be extended to such a case as this - whether a contracting party is entitled to the protection of the Court in the exercise of its jurisdiction, to decree the specific performance of agreements, by restraining a party to the contract from divulging the secret he has promised to keep that is a question that would require very great consideration. But the present case is not one which calls for the determination of it. If the Defendant has already disclosed the secret, the injunction can be of no use. If he only threatens to disclose, it then



becomes necessary to look at his affidavit; and by that he insists that what he has to disclose is no secret at all - Then how is the Court to try this question? or what can the Court do with the case altogether?" (The injunction was thus dissolved).

It is noted that Lord Eldon does not go so far as to say that secrets could in no circumstances be protected although it would seem that the hurdles he set up would be difficult to clear. In this context, the unauthorised learning of the secret in Yovatt v. Winyard takes on significance. The unauthorised acquiring of information and the possibility of gaining a remedy that will prohibit its use is mentioned in dicta in Tipping v. Clarke.<sup>43</sup> This accent on the method by which information is acquired takes on particular significance in the light of statements made in the leading case of Morison v. Moat.<sup>44</sup> This case is of particular significance in that the decision of the Vice Chancellor (Sir G.J. Turner) is couched in terms that were wider than necessary for the decision with a gloss being placed on earlier authorities. To compound matters the broader statements have in many instances been taken up in later cases without reference being made to the limitations on the broader dicta that is to be found in the Vice Chancellor's judgment.

A significant aspect of Morison v. Moat is that the problems crystallised at the time that a partnership agreement expired with the sons of the initial parties as the successors to their fathers in the partnership being the disputants. Morison Snr.

<sup>43</sup>(1843) 2 Hare 383, 393, 67 E.R. 157

<sup>44</sup>(1851) 9 Hare 241; 68 E.R. 492

was the inventor and sole proprietor of a secret recipe of a medicine who after some years of service with him had made a partner of Moat Snr. with Moat Snr. being told the secret and being charged with the task of manufacturing and selling the medicines. At the time the partnership was formed, each party entered a bond with a penal sum of Five Thousand Pounds with Moat Snr. covenanting to reveal the secret to no one and Morison Snr. covenanting to reveal the secret to no one other than such persons who may be brought into the partnership with the approval of Moat Snr.

After some years, two sons of Morison Snr. were brought into the partnership and the secret was revealed to them. Moat Snr. fell into ill-health and a son of his came to work for him on a fixed salary. This son was shortly afterwards named as the successor to Moat Snr. and a few days later Moat Snr. died. A few months after his father's death Moat Jnr. ceased regular attendance of the business and became a sleeping partner with Morison Snr. and the two sons carrying on the business. A few years later Morison Snr. died and his sons carried on the business until the time of the partnership came to an end a decade later. The dispute arose when the sons of Morison brought action against Moat Jnr. seeking an injunction to restrain Moat Jnr. from selling the medicine with the description "Morison's Universal Medicine", "prepared by Mr. Moat late partner of Mr. Morison the Hygeist."

The question for the court was could Moat Jnr. legitimately use the secret at the conclusion of the partnership? The following major points were canvassed:

- (a) The defendant argued that the secret was an asset of the partnership. On construction of the partnership deed and in the light of the mutual covenants it was held that the deed was not to this effect.
- (b) On an issue of fact it was argued by the defendant that he knew the secret through working on the process and this had been known by the other parties when rearrangements had been made following his father's death. In complete conflict with this the plaintiffs stated that there had been no intention of informing the defendant of the secret and it was on the assumption that he did not know it that the rearrangements had been made and he had been made a sleeping partner.
- (c) On a further issue of fact it was argued by the plaintiffs that the only ways the defendant could have come to know the secret was either through his father having divulged it to him in breach of his covenant or, alternatively, through surreptitiously acquiring the knowledge whilst associating himself with the partnership operations.



In the event the Vice-Chancellor came to the conclusion on the facts that it was (c) rather than (b) that had been made out. On this basis the authorities were referred to.

Perhaps it could only be by the advantage of hindsight that one could see a way that a decision of law could be resolved: accepting the conclusion on facts, one has mutual covenants secured by bonds, entered between partners to maintain secrecy for the benefit of their partnership with the parties having negotiated at arms length with each aware of the nature of the operations. A decision could have been based on a breach of the specific covenant found in this case and applying a remedy quite well established by equity at that stage to trace the result of the breach through to a third party who would have been aware of the breach. Instead the Vice-Chancellor expresses himself in terms of breach of faith, breach of confidence, breach of trust and breach of duty as well as breach of contract in making a finding for the plaintiffs.

The use of additional grounds may have provided little opportunity for confusion except that the scope of duties of faith, confidence, trust and duty are not indicated. Distortions of previous authorities are given when using the terms, thus complicating matters. The significance of the innovations warrant some detail: Williams v. Williams<sup>45</sup> is cited<sup>46</sup> only with respect to

<sup>45</sup> Supra note 42

<sup>46</sup> (1851) 9 Hare 256

Lord Kenyon's remarks on the son's alleged intention to take exclusive dominion of secret articles, an act which Lord Kenyon referred to as a possible breach of trust; the case is then characterised as one where trust must be honoured without mention being made of Lord Kenyon's refusal to grant an injunction against communicating the secret. Yovatt v. Winyard<sup>47</sup> is said to have been grounded on a breach of trust and confidence, an accurate observation, but an observation that could have been qualified by pointing to the acquisition of the information being in breach of trust etc. Abernathy v. Hutchinson<sup>48</sup> is represented as a case in which Lord Kenyon granted an injunction on the ground of breach of confidence rather than the actual ground selected by Lord Kenyon viz. an implied contract that students would not use notes of lectures to publish them for profit.

The generalisations made in Morison v. Moat provided rich resource material for later cases. It also provided the stimulus to Amedee Turner, the author of the established text on trade secrets, to give heavy accent to the fullness of scope of the law of trade secrets that may lie in an exploration of duties of confidence and trust.<sup>49</sup>

Despite the breadth of the terms used in Morison v. Moat there is dicta that should have served as a caveat to taking a literal view of these terms. Although deciding that the defendant had not acquired knowledge from working the process, the

<sup>47</sup> Supra note 38

<sup>48</sup> Supra note 27

<sup>49</sup> See especially Chapter 3 of A. Turner, "The Law of Trade Secrets".

following statement was made:

Undoubtedly, if the facts thus stated by the Defendant be proved - if the Defendant, after he became a partner in the concern, openly took part in compounding the medicines, and used the secret for the purpose - if, with the knowledge and concurrence of the partners, he was permitted to acquire, and did acquire, a full knowledge of the mode of compounding these medicines and of the secret process in the manufacture of them, it would be difficult for any of those partners afterwards to restrain him from using any knowledge so acquired or any secret so disclosed; they would, I think, in such a state of circumstances, be considered to have waived any right to preserve the secret for their separate benefit." 50

Although later cases tended to represent Morison v. Moat as authority for the proposition that it was a breach of faith and confidence for a person who had learnt a secret through his work to communicate the secret or use it elsewhere it is seen from the above dicta that the method of learning the secret was still given significance. An authorised learning of the secret could lead to a different result than the unauthorised learning of a secret that occurred in Yovatt v. Winyard.

A final peculiarity of Morison v. Moat is that Turner V.C. granted an injunction to restrain Moat from continuing to make and sell medicine made to the secret recipe, but refused to restrain Moat from communicating the secret. This he did on the ground that there had been no evidence or even allegation of an



intention to communicate. Little can be made of this save the absence of an automatic response in this regard. Perhaps the refusal by Lord Kenyon in the cases outlined earlier to grant injunctions against communication had some influence yet no direct mention is made of this.

An appeal by the defendant Moat to the Lord Justices was dismissed without any comment being recorded on the grounds for doing so.<sup>51</sup>

Passing mention was made by Jessel M.R. of Morison v. Moat in the case of Reuters Telegram Co. v. Byron.<sup>52</sup>

This case involved one Grenville who had acted in Australia as an agent working on commission for the plaintiffs. His task had been to collect cables from Australia and transmit to England and disseminate cables that were dispatched from England. Grenville's business was absorbed by that of the defendant Byron. When Byron failed in his negotiations with the plaintiffs for a better rate he set up his own cable service in competition with the plaintiffs and used in cables the cyphers which Grenville and Reuters had earlier worked out as abbreviations of the names of regular recipients of cables. The plaintiffs sought an injunction to restrain the use of these cyphers and any other records that Grenville had compiled.

<sup>51</sup> (1851) 9 Hare 267

<sup>52</sup> (1874) 43 L.J. (Ch.) 661

Jessel M.R. expressed doubts as to whether there could be any secrecy attached to the cyphers in that their purpose was to reduce cable charges by omitting complete addresses. He then referred to Morison v. Moat and said<sup>53</sup> that from that case

"The Court will always restrain a man from publishing or divulging that which has been communicated in confidence. But this is a totally different case. The plaintiffs here do not seek to restrain the defendants from publishing anything, but from making use of knowledge acquired while the relation of principal and agent subsisted after that relation terminated. Nor am I aware of any authority where this has been done in the absence of a contract express or implied."

Although Jessel M.R. refused to issue an injunction the juxtaposition of a broad interpretation of Morison v. Moat with the reference to nothing being done in the absence of contract tended to permit a further gloss in later cases. The gloss was that anything learnt in confidence could, by an implied contract, be restricted in use.

A continuation of this trend of broadening the previous authorities is to be found in Merryweather v. Moore.<sup>54</sup> The defendant had worked as a clerk for the plaintiffs, a firm of engine makers. Two days before leaving to work for another firm engaged in the same industry the defendant had compiled a table of

<sup>53</sup> Ibid. p.663

<sup>54</sup> [1892] 2 Ch. D. 518

dimensions of the various fire engines made by the plaintiffs. This was done without the knowledge or authority of the plaintiffs and was done when the defendant knew that he was leaving in two days.

On considering these facts Kekewich J. said:

"(the defendant) must be taken, whatever he says, to have intended to use them for his own purposes. Was it lawful for him to do that? Is it right that he should retain these materials? If he can carry them in his head no one can prevent his doing that and making use of them. But the question is, is not this an abuse of the confidence necessarily existing between him and his employers - a confidence arising out of the mere fact of employment, the confidence being shortly this, that the servant shall not use, except for the purposes of service, the opportunities which that service gives him of gaining information?"<sup>55</sup>

Kekewich J. concluded that his answer to this question must be "no" as he regarded an abuse of confidence was evidenced by the tables being compiled when "it is idle to say that it was done for any purpose that could be the slightest advantage to the employers".

Kekewich J. further observed<sup>55a</sup> that it may at times be permissible to take notes and use them elsewhere - copying of the precedents of a conveyancer or barrister were mentioned as examples. Therefore, circumstances could vary in different professions and trades.

<sup>55</sup> Ibid p. 524

<sup>55a</sup> Ibid p. 525



If all the matters viewed as relevant by Kekewich J. are taken into account the ratio of the decision could be expressed in the following narrow terms: Unless there is an authority express or implied to do so an employee is not to make a recording of confidential information of his employer that is not made towards the service of his employer and should he do so an injunction may be made to restrain the outside use of the recorded information.

Put in these terms, the case is analogous to that of Yovatt v. Winyard<sup>55b</sup> where the information was gained in an unauthorised, surreptitious fashion. Because it involved the unauthorised duplication of material, it is analogous to the de facto copyright case of Prince Albert v. Strange, a case that is referred to in the judgment. What the decision does not stand for, despite the suggestion to the contrary that is implied in the headnote, is that an employee is not permitted to gain information from his employer and use it other than in the employer's service. The dicta with respect to an employee being able to use information carried in his head (supra) indicates that gaining of information should be limited to gaining it by reproducing it or, possibly physically carrying it away.

The case of Robb v. Green<sup>55c</sup> had similar facts to Merryweather v. Moore. The employee secretly made an unauthorised

<sup>55b</sup> Supra Note 38

<sup>55c</sup> [1895] 2 Q.B. 1 (Q.B.); [1895] 2 Q.B. 315 (C.A.)

copy from the employer's order-book of names and addresses of customers. These customers were regular purchasers of pheasant eggs and live pheasants and were rarely visited as they were spread over England, Scotland and Wales. The object of the employee in making this copy of customers was so that he could solicit them for business when he went into business on his own behalf and this object was followed when he terminated his service with his employer. The employer brought action seeking damages and an injunction refraining soliciting his customers further.

The plaintiff succeeded in gaining damages and an injunction before Hawkins J. and the defendant appealed to the Court of Appeal. In affirming the judgment of the lower court, the members of the Court of Appeal expressed themselves in broad terms stating that it was an implied term of employment in a confidential position that an employee was bound to exercise good, faith. The copying of the customer list was held to be a breach of this implied term. There are no specific statements in the Court of Appeal judgments indicating the scope of duty of good faith. In this regard, the decision of Hawkins J. has greater interest.

Hawkins J. considered the argument put by defence counsel that unless restrained by contract (there was no specific constraint in this instance) a servant may lawfully set up in the same

line of business as his late master in the same locality.

Hawkins J. remarked<sup>55d</sup>

"(it was also argued that a servant) may, without fear of legal consequences, canvass for the custom of his late master's customers, whose names and addresses he has learned, bona fide accidentally, during the period of his service. I do not suppose that anybody, with any knowledge of the law, would seriously contend to the contrary."

An extension of the above argument was made by the counsel for the defendant which, in a reverse form, gained significance in later cases. It was urged that if it was permissible to solicit customers whose names had been remembered, then there should be no impediment to recording the names of customers as well. This extension was flatly rejected by Hawkins J. who pointed to the duty owed to the master during service which would be deliberately breached if a copy of names was to be made whilst obligated to serve the master. In making this distinction note was taken of the decision of Lord Kenyon in Nichol v. Martyn<sup>55e</sup> where a traveller for a merchant had told customers during his last round that he was about to set up on his own and would welcome business after his service with the merchant terminated. Lord Kenyon had found that the request for business had been prospective only with orders being taken for the traveller's master in the usual way and hence held that no injunction should be issued as the master's trade was still being served at the time. Hawkins J. regarded the decision as being

<sup>55d</sup> Ibid. p.13

<sup>55e</sup> (1799) 2 Esp. 732



near the dividing line of what constituted a breach of faith, but saw the deliberate copying of customers' names in the case before him as being beyond the line.

Whilst there had been use of broad terms relating to "confidence", "good faith" and "trust" in the decisions outlined up to this point, there had been little specific comment on the scope of the terms. This had generally been unnecessary due to the activities in question being acts carried out during the employment without them being connected with the service of the employer. Some specific comments were made in the case of Louis v. Smellie<sup>55f</sup> by Kekewich J. which tended to carry the law into previously uncharted territory.

The plaintiff carried on business as a process server under the refreshing title of "Flowerdew & Co." The defendant entered the plaintiff's service as a lad employed first as a clerk and then as a process server until he terminated the employment and started a similar business under the contrasting title of "Smellie & Co." The plaintiff brought action against the defendant seeking damages and an injunction alleged that the defendant had taken advantage of his employment to secretly make, for his own purposes, extracts from the plaintiff's register of agents and copies of the plaintiff's forms.

<sup>55f</sup> (1895) 73 L.T. 226; 11 T.L.R. 336

The decision of Kekewich J. is puzzling. He mentions Robb v. Green<sup>55g</sup> and Lamb v. Evans<sup>55h</sup> and remarking that the doctrines of the court are made clear in those authorities, he stated<sup>55i</sup>

"It is sufficient to say by way of summary that no servant or pupil is allowed to use the industry or skill of his master further or otherwise than is provided by the express or implied terms of the bargain between them. This statement avoids any distinction between the use by copying or the like, or by an effort of memory. And it is the logical result of the doctrine that no such distinction exists. Are the register and index of agents, and are the forms employed by the plaintiff works of skill and industry deserving protection? Speaking generally, and without reference for the moment to any particular document, and independently of course of copyright, I entertain no doubt that they are all of this character."

These remarks on the use of memory stand in contrast to the very opposite statement that Kekewich J. himself made in Merryweather v. Moore<sup>55j</sup> (a case he does not mention) just three years earlier. Furthermore, the lack of distinction between copying and memory that His Lordship finds amount to an acceptance of the argument that the defence was pressing for the opposite purpose in Robb v. Green, an argument that had been rejected by Hawkins J.

<sup>55g</sup>Supra Note 55c

<sup>55h</sup>Supra Note 35

<sup>55i</sup>73 L.T. 226

<sup>55j</sup>Supra Note 54

After breaking new ground, however, Kekewich J. went back on himself to a fair extent by stating that the defendant was entitled to compete with the plaintiff and that no fault would be found if, through experience with the plaintiff, the defendant remembered a reliable agent and appointed him. This line of reasoning led Kekewich J. to the conclusion that whilst he thought that names of agents may have been wrongfully taken from the plaintiff's register he did not see his way clear to restrain the defendant from using the same agents as the plaintiff. He also thought that the use of forms did not merit separate attention and concluded by awarding nominal damages only. The defendant appealed to the Court of Appeal.<sup>55k</sup>

The judgments of the members of the Court of Appeal did not directly refer to the broad dicta of Kekewich J. This was because it was found that the defendant was an untrustworthy witness who had perjured himself in several instances which therefore led to a conclusion of fact that a good deal more in the shape of extracts from the plaintiff's register had been taken by the defendant than he admitted. The members of the Court of Appeal noted that there was no covenant in the employment agreement against the defendant competing with the plaintiff and hence mentioned that care had to be taken to avoid giving a result equivalent to enforcing such a covenant. On this basis Lindley L.J. ruled that the plaintiff was entitled to an injunction restraining the defendant

<sup>55k</sup> (1895) 73 L.T. 227; 11 T.L.R. 515; [1895-9] All E.R. Rep. 875.



from using any copies or extracts that he had made of his employers register, index memoranda or forms. Lindley L.J. concluded by saying that if the defendant happened to remember an agent whose address he can find out from the ordinary directories he was at liberty to do so.

Lopes L.J. and Rigby L.J. in separate judgments briefly indicated their concurrence with the order of Lindley L.J. Although the facts as found by the Court of Appeal led to there being no material difference between the case and earlier ones where unauthorised notes had been taken a broad statement by Lopes L.J. is worthy of note because it tends to cover similar ground to that of Kekewich J. and because it is made the basis of the headnote found in the Law Times report, a headnote that is repeated verbatim in the All England Reprints. After noting that there was no covenant preventing the defendant going into competition with the plaintiff, Lopes L.J. said<sup>551</sup>

"But, although he was entitled to set up as a rival to the plaintiff he was not entitled to use any materials or any information which had been acquired by him when he was in the confidential employ of the plaintiff."

It is readily apparent that this statement covers many circumstances beyond those that were material in Louis v. Smellie. No distinction is made between information acquired as

part of an employee's duties and information that may be acquired through unauthorised activities. Nor is any account taken of information that has become part of the make-up of an employee, part of his ordinary knowledge and experience, and other information. In fact, due to the way in which the statement is expressed, no distinction is made between information that is generally known by the public and confidential information. If taken at face value the entitlement to set up as a rival is a hollow right in that employee would be quite an ineffective rival if he was not permitted to use any information he had gained earlier.

Perhaps there would have been some modification of the broader statements made in the above cases if note had been taken of the dicta in Leather Cloth Co. v. Lorsche<sup>55m</sup> where some attention was given to the public interest in a man being at liberty to use his labour, skill or talent. This was considered, albeit briefly, in the context of determining the reasonableness of a specific covenant against communicating processes of manufacturing leather. If the skills of an employee had been more specifically contemplated in the above cases the opportunity may have been taken to indicate the type of information that could be used by an ex-employee.

None of the cases discussed to this point involved specific covenants prohibiting use of information or material acquired from another party. It would seem open to a person in

<sup>55m</sup> (1869) L.R. 9 Eq. 345, 354

possession of information or material that he did not wish to have used other than for his own purposes to avoid any of the doubts that could arise through reliance on terms implied by the courts by extracting specific covenants from the persons with whom he contracted. These covenants could be drafted to prohibit use of information or material for purposes other than carrying out the contract. More drastically, they could prohibit any later competition. The problem that would arise with such covenants would be that they might be susceptible to being struck down as being in restraint of trade.

The development of the common law doctrine against restraint of trade will now be examined with the accent being placed on its affect on the law of trade secrets.

#### 4. Early Development of the Law of Contracts in Restraint of Trade.

The well known case of Nordenfelt v. Maxim Nordenfelt Guns and Ammunition Company, Limited<sup>56</sup> is the usual starting point for standard contract texts on the law respecting contracts in restraint of trade. In that case Lord Macnaghten laid down what was regarded until recently as the "modern" approach to such contracts:<sup>57</sup>

"The true view at the present time I think is this: the public have an interest in every person's carrying on his trade freely: so has the individual. All interference with individual liberty of action in trading

<sup>56</sup> [1894] A.C. 535

<sup>57</sup> Ibid p. 565.



and all restraints of trade of themselves, if there is nothing more, are contrary to public policy, and therefore void. That is the general rule. But there are exceptions: restraints of trade and interference with individual liberty of action may be justified by the special circumstances of a particular case. It is a sufficient justification, and indeed it is the only justification, if the restriction is reasonable - that is, in reference to the interests of the parties concerned and reasonable in reference to the interests of the public, so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public. That I think, is the fair result of all the authorities."

This statement has a semblance of clarity that can mislead. The problems of interpretation do not arise so much from difficulties in applying a "reasonableness" test, a test well known in various areas of the law, but in becoming appraised of the interests that may merit consideration in determining reasonableness. Before Lord Macnaghten delivered his judgment traditions that had almost gained the status of rules of law had been developed on the matters that could be taken into account and these traditions tended to carry on after the Nordenfelt case.

The members of the House of Lords in Nordenfelt virtually congratulated themselves in making a decision that took into account the manner in which communication and mobility had increased since earlier times. With the wisdom of hindsight, however,

the decision is far from forward-looking in policy terms. Although often based on different grounds the attitudes to regulating commerce and striking out fetters in competition in the time of Queen Elizabeth I had much more in common with those prevailing in the time of Queen Elizabeth II than the Victorian version. There had been an extended period of whittling away of the seventeenth and early eighteenth century stance on restraint of trade by the laissez-faire approach and its related notion of sanctity of contract during the late eighteenth century and the whole nineteenth century. The Nordenfelt decision in effect entrenched the laissez-faire attitude despite the use of the normally flexible "reasonableness" criteria.

The House of Lords in the Nordenfelt case did not strike out a restraint of trade. To the contrary, new ground was broken in that a world-wide restraint was upheld. Although often villified the generally accepted rule prior to Nordenfelt was that a distinction had to be made between a partial (i.e. limited) restraint and a general restraint: a general restraint was always void whereas a partial restraint could be justified. Quite clearly the artificial nature of the distinction had become apparant and some reassessment was due. In making the reassessment, however, there was not a return to the initial considerations that had led to the distinction being made in the first place.

The source of the partial restraint as against general restraint distinction was Mitchel v. Reynolds<sup>58</sup> where Lord Macclesfield (Parker C.J. as he then was) gathered the authorities and by setting himself an elaborate series of questions and answers canvassed the policy issues involved in restraints of trade. His reasoning is worthy of examination in some detail as a background to the significant changes that occurred over the years through subtle shifts in emphasis.

Lord Macclesfield considered all nature of restraints and grouped them initially as involuntary restraints, that is, restraints in which the ordinary individual had no say and voluntary restraints. In the area of voluntary constraints only "particular" restraints, that is, restraints relating to limited places or persons, were held to be justifiable. A particular restraint could not be good, however, unless it was with "just reason and consideration"<sup>59</sup> and, as had been mentioned earlier in the judgment consideration needed to be "good and adequate."<sup>60</sup> Abuses that Lord Macclesfield saw as being likely except for such a rule was that<sup>61</sup>

"corporations who are perpetually labouring for exclusive advantages in trade, and to reduce it into as few hands as possible; as likewise from masters, who are apt to give their apprentices much vexation on this account, and to use

<sup>58</sup> (1711) 1 P. Wms. 181; 24 E.R. 347

<sup>59</sup> (1711) 1 P. Wms. 181, 187

<sup>60</sup> Ibid. p.186

<sup>61</sup> Ibid. p.190



many indirect practices to procure such bonds from them, lest they should prejudice them in their custom when they come to set up for themselves."

On the other side it was thought that restraints could find favour where<sup>62</sup>

"they may be useful and beneficial, as to prevent a town from being overstocked with any particular trade; or in case of an old man, who finding himself under such circumstances, either of body or mind, as that he is likely to be a loser by continuing his trade, in this case it will be better for him to part with it for a consideration, than by selling his custom he may procure to himself a livelihood which he might probably have lost by trading longer."

Lord Macclesfield saw dangers in rejecting restraints altogether because this would involve setting aside a man's own agreement through fear that there may be some injury to him when clearly there would be damage to the other if a restraint was not upheld.

In total Lord Macclesfield takes into account: liberty of the individual to carry out his trade, viewed as being of importance for the individual and because the public interest was against idleness; the need to avoid where possible the evils of monopoly; the advantages that could accrue through persons moving from their trades and the desirability of permitting restraints

<sup>62</sup> Ibid. p.191

that were not injurious and oppressive and were demonstrated to be such from the good consideration provided.

It was on these grounds that the conclusion was reached that a general restraint could never be good. If a restraint was general it would provide a complete monopoly and that was against the policy of law.<sup>63</sup> Next, it was thought that a general restraint would fix a certain loss on one side without there being any benefit to the other.

It was on this last point that the House of Lords in the Nordenfelt case disagreed. The change in communications and transport since the time of Mitchel v. Reynolds had brought about the situation that there could be a detriment to a covenantee unless there was a general restraint.

There was another ground, however, that Lord Macclesfield regarded as significant in ruling that a general restraint must be bad. This ground appears to have been completely overlooked in later cases as changes in permitted remedies took place, but it does seem to go a long way in explaining the reason for making a distinction between general and particular restraints. The ground related to the bond that was involved in Mitchel v. Reynolds. Bonds were often executed in support of a restraint before and after this case.

<sup>63</sup> Ibid. p.187. Lord Macclesfield makes an assessment here that would not survive modern analysis. In the course of his judgment he makes a distinction between a monopoly in a limited (but significant) area - undesirable yet open to justification - and a complete monopoly. This seems to be based on the idea that patents of invention give a complete monopoly and under the Statute of Monopolies these are the only monopolies permitted.

At common law in the early seventeenth century, the whole bond could be recovered for a breach of covenant. A problem that was just beginning to emerge was the question of whether a bond could be exacted in the way of a penalty without demonstrating any actual damage. Whilst a penalty was permitted, there were some constraints placed on the situations in which it would apply and it was through bringing about a compatibility of the restraint of trade rules with the normal approach to bonds that assisted Lord Macclesfield in coming to his conclusions. For a penalty, consideration was essential and there was a need to show that injury would take place if the covenant was breached, as without damage no penalty was appropriate. The example that Lord Macclesfield borrows from a much noted comment of Judge Hull (2 Hen V. fo. 5) highlights the type of situation that was to be avoided:<sup>64</sup>

"for suppose...a poor weaver, having just met with a great loss, should, in a fit of passion and concern, be exclaiming against his trade, and declare that he would not follow it any more, etc., at which instant, some designing fellow should work him up to such a pitch, as, for a trifling matter, to give a bond not to work at it again, and afterwards, when the necessities of his family and the cries of his children send him to the loom should take advantage of the forfeiture, and put the bond in suit; I must own, I think this such a piece of villainy, as is hard to find a name for.... Surely it is not fitting that such unreasonable mischievous contracts should be countenanced, much less executed by a Court of Justice."

<sup>64</sup> Ibid. p.193



This nice piece of melodrama indicates a rejection of arrangements where a sum may become due to a party who otherwise had no interest in an event. Analogies might be made with an insurance policy holder with no insurable interest or with an outright gambling contract. It would seem to be the rejection on this ground as much as a repugnance to restraint of trade that encouraged the comment.

In a sequence of cases after Mitchel v. Reynolds, the various elements that Lord Macclesfield regarded as significant were given different functions so that they no longer fitted into the framework that Lord Macclesfield had erected. His requirement that the covenantee must be open to some injury for breach of a covenant was taken up but given quite a different accent. Whereas in Mitchel v. Reynolds a covenantee could in no circumstances succeed unless there was potential damage that could justify payment of the bond the test became one of a covenantee would succeed if he could show potential damage.

The changes that took place over the years in remedies made this a peculiar rule. Bonds lost the significance attached to them under the common law rules prevailing in 1711. At equity, specific performance, or in the restraint of trade field its negative equivalent, an injunction, would be ordered and the bond merely acted as a security. In time, a defendant was not permitted to escape an injunction by tendering the bond.<sup>65</sup> In the

<sup>65</sup> Fox v. Scard (1863) 33 Beav. 327; 55 E.R. 394; National Provincial Bank of England v. Marshall (1889) 40 Ch. D. 112.

late nineteenth century, the posting of bonds fell out of fashion and, in any event, the distinction that the courts began to make between penalties and liquidated damages would have made Lord Macclesfield's concern for the possible misuse of bonds quite irrelevant.<sup>66</sup>

When the courts began to grant injunctions exclusively the question of whether a restraint was such as to protect the covenantee from potential injury often became an empty exercise. Why would a covenantee go to the trouble of gaining an injunction unless the covenantor's activities were injuring him? The only problem that would arise would be in determining the scope of the injunction so that a covenantee did not have to keep returning to the court on the one covenant. The willingness of courts in many instances to sever any restraints that went beyond those activities that could harm the covenantee<sup>67</sup> meant that the only thing required was aware drafting of covenants that allowed ready severance of any embarrassing overreach. This could place a covenantee in a position where he could take successful proceedings as he saw fit.

A further change took place after Mitchel v. Reynolds that was of great significance. In Mitchel v. Reynolds there was heavy accent placed on the issue of consideration. If a restraint was to be accepted "good and adequate" consideration

<sup>66</sup> For an illuminating note on the change in functions of penalties see J.L. Barton "Penalties and Damages" (1976) 92 L.Q.R. 20.

<sup>67</sup> Mallan v. May (1843) 11 M & W 653; 152 E.R. 967 was the first significant case where an overwide restraint was separated from a valid restraint and severability of invalid aspects took place in a host of cases thereafter. Lord Macnaughten recognised severability in Nordenfelt's case [1894] A.C. 535, 561.

was essential in order to counterbalance the detrimental effects that could arise through reduction of individual liberty and potential for enhancing monopoly positions. The consideration element was fully recognised in Young v. Timmins<sup>68</sup> where there was a contract whereby a brass-founder was to do work exclusively for the covenantees. All the members of the Court of Exchequer Chamber found fault with the restraint due to the lack of obligation placed on the covenantee to provide any work, let alone sufficient work for the covenantor. Consideration was the principle issue examined by the court with Bayley B. saying<sup>69</sup>

"If I could find in this agreement any obligation on the part of the (covenantees) to furnish (the covenantor) with an adequate quantity of work, I should say that there was adequate consideration; but if there is nothing in this agreement to oblige them to furnish an adequate quantity of work, and especially if it appears probable, from the nature of the instrument, that it may happen that the (covenantor) might be left without sufficient employment by the defendants then the consideration in this case fails."

The whole law of contracts was being subjected to readjustment in the nineteenth century on the issue of consideration and the accent given to consideration in Young v. Timmins made it stand out from other cases in the contract field. The need for consideration to be treated differently in restraint of trade cases because its adequacy or otherwise bore an intimate relationship with reasonableness was rejected in Hitchcock

<sup>68</sup> (1831) 1 C. & J. 330; 148 E.R. 1446.

<sup>69</sup> Ibid. p.340.



v. Coker.<sup>70</sup>

Tindal C.J. in delivering the judgment of the Court of Exchequer Chamber referred to the argument advanced by the defence on adequacy of consideration. He said:<sup>71</sup>

"Undoubtedly in most, if not all, the decided cases, the Judges, in delivering their opinion that the agreement in the particular instance before them was a valid agreement, and the restriction reasonable, have used the expression, that such agreement appeared to have been made on an adequate consideration, and seem to have thought that an adequacy of consideration was essential to support a contract in restraint of trade. If by that expression it is intended, only, that there should be a good and valuable consideration, such consideration as is essential to support any contract not under seal, we concur in that opinion.... But, if by adequacy of consideration more is intended, and that the Court must weigh whether the consideration is equal in value to that which the party gives up or loses by the restraint under which he has placed himself, we feel ourselves bound to differ from that doctrine.... It is enough, as it appears to us, that there actually is a consideration for the bargain; and that such consideration is a legal consideration, and of some value."

Any clarification that these words may have needed was promptly provided by Archer v. Marsh<sup>72</sup> when Lord Denman C.J. mentioned that judgment in the case had been postponed until

<sup>70</sup> (1837) 6 A. & E. 438; 112 E.R. 167

<sup>71</sup> Ibid. p.456.

<sup>72</sup> (1837) 6 A. & E. 959; 112 E.R. 366.

Hitchcock v. Coker had been resolved and that it was now clear that<sup>73</sup>

"the parties must act on their view of what restraint may be adequate to the protection of the one, and what advantage a fair compensation for the sacrifice made by the other."

To similar effect, Parke B. stated in Leighton v. Wales<sup>74</sup>

"The agreement is good if there be a sufficient consideration in law to support a contract...and it is clear, since the case of Hitchcock v. Coker, that the Court cannot inquire into the extent or adequacy of the consideration."

The fading of the importance of consideration in the restraint of trade area is of even greater significance when it is noted that in Hitchcock v. Coker itself the test applied on reasonableness of the restraint provided a heavy burden for any covenantee. A restraint was unreasonable if it was "larger and wider than the protection of the party with whom the contract is made can possibly require."<sup>75</sup> In applying this test the Court could not find accord with the Court of King's Bench that a restraint unlimited in time was beyond what could possibly be required by a druggist over his assistant. The Court saw the possibility that the King's Bench apparently overlooked that the druggist may wish to sell his business at some stage and it was appropriate that freedom from competition from an assistant could be sold as part of the goodwill.<sup>76</sup>

<sup>73</sup> Ibid. p.967

<sup>74</sup> (1838) 3 M. & W. 545, 551; 150 E.R. 1262.

<sup>75</sup> (1837) 6 A. & D. 454

<sup>76</sup> Ibid. p.455

In the light of the shifts in accent that the law had been undergoing since Mitchel v. Reynolds it may seem that Lord Macnaghten's statement<sup>77</sup> in the Nordenfelt case reversed the general trend. It may have been capable of doing so if the reasonableness with respect to the parties and reasonableness with respect to the public interest had been taken at face value without the colouring that earlier cases lent it. The sub clause

"so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed while at the same time it is in no way injurious to the public,"

gave the indication that the nineteenth century traditions were to continue. Although this qualification could have been applied as part of the "reasonableness in the interests of the parties" test with only adequate protection being permitted to the covenantee it was interpreted in the old pattern: if a restraint was needed to protect the covenantee it was reasonable in the interests of the parties.

Furthermore, the public interest considerations did not fare well. This was because freedom of contract with an obligation to honour one's covenants remained a high public interest consideration.<sup>78</sup> Public interest considerations in the way of liberty of the subject were overlooked - this was because liberty, it seemed, received sufficient recognition from freedom of contract. The public interest in promoting competition also

<sup>77</sup> *Supra* note 57

<sup>78</sup> See Lord Watson in Nordenfelt [1894] A.C. 555 who gave higher weight to "common honesty in private transactions" than the "stern" forbidding of restraint of trade.



received scant attention.<sup>79</sup> Any possibility of making a proper review of such matters was, in any event, given an early setback by the ruling that reasonableness depended on the construction of a contract and its legal effect, a question which a court alone could resolve thus making opinions of witnesses out of place.<sup>80</sup>

Another issue that significantly restricted the impact of Lord Macnaghten's statement was the burden of proof. One might suppose that Lord Macnaghten indicated that contracts in restraint of trade were prima facie void and would have to be justified by the party seeking to have a covenant enforced. This was not to be the case, however, in that in later cases the burden with respect to the public interest factors was clearly placed on the covenantor. As the Privy Council stated in A.G. of the Commonwealth of Australia v. Adelaide Steamship Co. Ltd.<sup>81</sup>

"the onus of showing that any contract is calculated to produce a monopoly or enhance prices to an unreasonable extent will lie on the party alleging it, and that if once the Court is satisfied that the restraint is reasonable as between the parties this onus will be no light one."<sup>82</sup>

<sup>79</sup> In A.G. of the Comm. of Australia v. Adelaide Steamship Co. Ltd. [1913] A.C. 781, 795. This ground alone was noted to have never been successfully argued.

<sup>80</sup> Haynes v. Doman [1899] 2 Ch.D. 13, 24 per Lindley M.R. and Dowden v. Pook [1904] 1 K.B. 45.

<sup>81</sup> [1913] A.C. 781, 796

<sup>82</sup> To similar effect, Herbert Morris Ltd. v. Saxelby [1916] A.C. 688 per Lord Atkinson at 700 and Lord Parker reasserts his statement of Adelaide Steamships at 708.

The burden was indeed "no light one" when account was also taken of the refusal of the courts to accept expert witnesses on the matter and the "legal" question of public interest had a strong bias towards honouring private transactions. Accordingly, it is not very surprising to note that except for an unusual fact situation that arose in one instance<sup>83</sup> there were no cases in which a restraint found reasonable in the interests of the parties was held void through being against the public interest.

There was partial mitigation of this, however, due to the manner in which de facto public interest considerations could be taken into account in determining reasonableness in the interests of the parties. If it was truly the case that consideration would not be investigated and freedom of contract was assumed then the courts would not have made the distinction that they did make between restraints arising in employer-employee relationships and restraints to do with the sale of a business. This was done by making distinctions between what was eligible for protection in the covenantee's interests depending on the nature of the contract. It was also done by giving recognition to the fact that there may be more freedom of contract in some circumstances than others. This factor could be assimilated by a narrowing of interests eligible for protection in the test of the reasonableness of the restraint.

<sup>83</sup> Kores Manufacturing Co. Ltd. v. Kolok Manufacturing Co. Ltd.  
[1959] Ch. D. 108

With respect to confidential information and trade secrets the narrowing of interests that a covenantee could legitimately protect had an impact. The earlier situation is reflected in Mallan v. May.<sup>84</sup> An agreement between a dentist and his assistant contained a covenant that the assistant would not practice anywhere in London (and other places) after terminating the employment. No time limit was placed on the restraint. After severing the places other than London from the restraint, it was upheld as reasonable. Parke B. noted that it was quite acceptable in the sale of a business to have the goodwill protected by a restraint and continued:<sup>85</sup>

"And such is the class of cases of much more frequent occurrence, and to which the present case belongs, of a tradesman, manufacturer, or professional man, taking a servant or clerk into his service, with a contract that he will not carry on the same trade or profession within certain limits.... In such a case the public derives an advantage in the unrestrained choice which such a stipulation gives to the employer of able assistants, and the security it affords that the master will not withhold from the servant instruction in the secrets of his trade, and the communication of his own skill and experience, from fear of his afterwards having a rival in the same business.... In the present case...the defendant was to be instructed in a business requiring skill and intelligence, and upon the principles above laid down, the contract not to exercise the same business, within certain reasonable limits, was not invalid."

<sup>84</sup> (1853) 11 M. & W. 653; 153 E.R. 967.

<sup>85</sup> Ibid. p.666.



Similarly, in Mumford v. Gething<sup>86</sup> a

restraint placed on a traveller for a merchant to refrain from travelling in the same area as his employer for anyone else after termination of the employment was held to be reasonable. Erle C.J. observed<sup>87</sup>

"If the law discouraged such agreements as these, employers would be extremely scrupulous as to engaging servants in a confidential capacity, seeing that they would incur the risk of their taking advantage of the knowledge they acquired of their customers and their mode of conducting business and then transferring their services to a rival trader.

This type of approach continued even after the Nordenfelt case when the Court of Appeal in Haynes v. Doman<sup>88</sup> enforced a restraint on an employee to refrain from carrying out the same kind of business within twenty-five miles of the employer, a hardware merchant. There was also a covenant against divulging the secrets or mode of conducting business. This led to the case being later characterised as a trade secret case<sup>89</sup> although no mention of the actual existence of secrets was made. Whilst the burden was placed on the defendant to prove that the restraint<sup>90</sup>, went beyond what was reasonably necessary, he was not permitted to lead evidence on reasonableness as this was said to be a question of law. The only evidence permitted was that showing the general

<sup>86</sup> (1859) 7 C.B. (N.S.) 305; 141 E.R. 834

<sup>87</sup> Ibid. p.319

<sup>88</sup> [1899] 2 Ch.D. 13

<sup>89</sup> Mason v. Provident Clothing and Supply Co.Ltd. [1913] A.C. 724, 740.

<sup>90</sup> Ibid. p.30 per Rower L.J.

nature of the business so that it could be seen "what precautions are required to protect a person carrying on the business from injury by a person leaving his service."<sup>91</sup>

In Haynes v. Doman all accent was placed on the employer's interests with no reflection made on the limited choice that the employee had in the matter. The facts, as stated by Lindley M.R., reveal that the defendant had worked for a rival merchant before joining the plaintiff and he had changed employment because his father, who already worked with the plaintiff, had been told his employment would be terminated if his son continued his contact with the rival. These circumstances drew no comment from the Court.

The effect of the above cases was to give the same treatment to the covenantees' interests whether he gained the protection of a restraint through being an employer of a person who may be of value to a rival or gained it through being the purchaser of a business. The connection was specifically stated in Mallan v. May.<sup>92</sup> The protection granted was protection from competition per se. No note is taken in the judgments in Haynes v. Doman of the "labour, skill or talent" of an employee that is mentioned in Leather Cloth Co. v. Lorsont<sup>93</sup> as qualities that should be taken into account in determining the reasonableness of a restraint.

<sup>91</sup> Ibid. p.24 per Lindley M.R.

<sup>92</sup> Supra note 84.

<sup>93</sup> (1869) L.R. 9 Eq. 345, 353

The general theme may have continued but a distinct change of emphasis occurred when the House of Lords had an opportunity of considering a restraint on an employee in Mason v. Provident Clothing and Supply Co. Ltd.<sup>94</sup> Lord Shaw saw the double effect of permitting an overwide restraint in that it could become "a means of coercing and punishing the workman and putting him under a tyrannous and, therefore, a legally indefensible restraint."<sup>95</sup> A similar comment was made by Lord Moulton who saw the wide restraint as "a penal rather than a protective covenant.. (designed).. to paralyse the earning capabilities of the man if and when he left their service".<sup>96</sup>

In contrast with the earlier cases where an employer, by showing he had some interests to protect, was permitted protection of all his interests the House of Lords required far greater specificity in a restraint. It was suggested that it may have been reasonable to restrain the canvasser-employee from canvassing for someone other than his employer the customers that he had dealt with during the employment<sup>97</sup> and such a restraint should only be for a reasonable interval, sufficient to permit the employer time to establish another employee in the position.<sup>98</sup>

<sup>94</sup> [1913] A.C. 724

<sup>95</sup> Ibid. p. 741

<sup>96</sup> Ibid. p. 746.

<sup>97</sup> Ibid. per Viscount Haldane 734, per Lord Shaw 741.

<sup>98</sup> Ibid. per Lord Moulton 743.



The point that clearly emerges is that when considering the reasonableness of a restraint it should be examined from the point of view of allowing no more than what is reasonably necessary for the covenantee rather than from the view of what the covenantee may find desirable. Furthermore, Lord Moulton, in rejecting the suggestion that any overwide aspects of the restraint should be severed stated that this would only be done if the excess was clearly severable and only of a trivial importance and not a part of the main purport and substance of the restraint. He observed<sup>99</sup>

"It must be remembered that the real sanction at the back of these covenants is the terror and expense of litigation, in which the servant is usually at a great disadvantage, in view of the longer purse of his master."

An argument that had been pressed on behalf of the employer was that the employee had acquired information and knowledge of the business that should not be available to be used against the employer. The nature of the information and knowledge was held to not merit such protection. Lord Shaw adopted a passage from the judgment of Farwell L.J. in Sir W.C. Lang & Co. v. Andrews<sup>100</sup> in which he said that an employee cannot be prevented from using the skill and knowledge in his trade or profession which he has learned in the course of employment

<sup>99</sup> Ibid. p.745

<sup>100</sup> [1909 1 Ch. D. 763, 773.

by means of directions or instructions from the employer. Lord Shaw stated that trade secrets may merit protection but they differed from that part of the equipment which becomes part of himself.<sup>101</sup> He said that one was objective knowledge and the other subjective knowledge.

The type of knowledge acquired by an employee that will be immune from a restraint was the matter directly at issue in Herbert Morris Ltd. v. Saxelby,<sup>102</sup> another decision of the House of Lords. The facts of the case are set out in detail in the report of the decision of Sargent J. in the Court of Chancery.<sup>103</sup> The defendant had been employed by the plaintiffs first as a draftsman and then as an engineer. The plaintiffs were leaders in their line of business which was the manufacture and sale of lifting machinery. For the purpose of carrying out their business the plaintiff company had prepared many charts, drawings and tables that gave strengths of materials, stresses, costing details etc. The defendant made regular use of this material during the course of his duties. There were two clauses of the defendant's employment contract relevant to the case. Under one clause the defendant was not to divulge or communicate any "information" which he may receive or obtain on the plaintiff's affairs. By the other clause he was not to act as principal, agent or servant for a period

<sup>101</sup>[1913] A.C. 740. See too Viscount Haldane, 734.

<sup>102</sup>[1916] A.C. 688

<sup>103</sup>[1915] 2 Ch.D. 57

of seven years after termination of his employment in the manufacture or sale of pulley blocks, overhead runways or travelling cranes in the United Kingdom or Ireland. After the defendant left the plaintiff's service he was unsuccessful in gaining an engineering position in the United Kingdom in fields outside the plaintiff's activities so he moved to France and worked for a firm in the same line of business as the plaintiff. France did not suit the defendant so within a year he returned to the United Kingdom and because the French firm had placed him under a restraint against working for the plaintiff company, he commenced work for a rival company. The plaintiff brought action under the employment agreement.

The divulging or using of the information gained whilst in the plaintiff's employ was made a central issue. Sargent J. laid accent on the following evidence given by Herbert Morris for the plaintiff company:<sup>104</sup>

"Q: Suppose defendant goes into (a rival's) employ and keeps his obligation not to communicate?

A: If he used his knowledge he would do us harm, if not, he would be no use - this is as to the particular things. I object to his using as well as to his divulging..."

and later

"A:...I want to avoid competition as much as possible...I don't mind competition in the ordinary course of business but do mind it by persons who have gained experience with us."



Sargent J. categorised<sup>105</sup> the information that the defendant would have retained through memory of the plaintiff's operations, charts, etc. as "subjective" rather than "objective" information and it was not permissible for the plaintiff to protect itself from the use of such information. He thought that there were no "trade secrets" as against "confidential information" involved in the case.

The Court of Appeal, by a majority, upheld the dismissal of the plaintiff's action.<sup>106</sup>

The House of Lords dismissed the plaintiff's appeal and in doing so approved the approach adopted by Sargent J. The sheets, cards, formulae and documents of the plaintiff were categorised as confidential information rather than trade secrets and hence any recollection that the defendant may have of them was held to be information the defendant was free to use.<sup>107</sup>

A major difficulty that arises in interpreting the Morris v. Saxelby decision is that there is no description, let alone definition of what constitutes trade secrets. It is clearly stated that trade secrets may be the subject of protection<sup>108</sup> but other than a statement by Lord Parker that certain formulae may have come close to being a trade secret<sup>109</sup> the only indicator given is that a great

<sup>105</sup> Ibid. p. 69

<sup>106</sup> [1915] 2 Ch. D. 75

<sup>107</sup> [1916] A.C. 688; per Lord Atkinson p. 703; per Lord Parker p. 712

<sup>108</sup> Ibid per Lord Atkinson p.702; Lord Parker p.709; Lord Shaw p.714.

<sup>109</sup> Ibid. p.712.

deal of material, probably prepared at considerable expense, was not categorised as trade secrets but as confidential information which an employee may absorb and take with him.

With respect to confidential information an exception to the decision in Morris v. Saxelby was indicated for different circumstances. It was said that a restraint could be placed on an employee using confidential information with respect to customers in order to entice them away from an employer.<sup>110</sup> Hence personal contacts differed from technical knowledge.

Although trade secrets could be subject to protection a possible limit in this area was seen by Lord Parker. After reviewing the nature of the material and concluding that none of it constituted a trade secret he said<sup>111</sup>

"It would be a point of some difficulty whether the possession by an employee of a single trade secret would justify a restraint as wide as that in the present case."

This comment is a result of Lord Parker's development of a theme that he had delivered earlier in his speech on the narrower scope of restraint that was permitted in the case of a restraint on an employee as against a restraint on a vendor in the sale of his business. This was because the goodwill of a business is immune from the owner exercising his personal knowledge

<sup>110</sup> Ibid per Lord Atkinson p.702; Lord Parker pp.709, 710; Lord Shaw p.715.

<sup>111</sup> Ibid. p.712.

and skill to its detriment and therefore, upon the owner selling that goodwill the immunity should carry on to the purchaser.

He said<sup>112</sup> -

"It is quite different in the case of an employer taking such a covenant from his employee or apprentice. The goodwill of his business is, under the conditions in which we live, necessarily subject to the competition of all persons (including the servant or apprentice) who choose to engage in a similar trade. The employer in such a case is not endeavouring to protect what he has, but to gain a special advantage which he could not otherwise secure."

As the material in Morris v. Saxelby was held to be other than trade secrets, it would be rash to draw any firm conclusion from these remarks, but the strong implication is that of the material covered by the general category of confidential information and trade secrets, there is much more that can be subject to a legitimate restraint in the case of a vendor's sale of goodwill than in an employee restraint. In fact, Sargent J. in the court below had stated that the material involved in Morris v. Saxelby could have been legitimately restrained if it had been the subject of a sale of the business. It flows from this that the position where the line can be drawn will in turn depend on how rigorous a restraint is placed on an employee.

<sup>112</sup> Ibid. p.709



The only restraint of trade case directly involving a trade secret before Morris v. Saxelby was Leather Cloth Co. v. Lorstont.<sup>113</sup> That case involved the sale of trade secrets and therefore it was bound up in a goodwill issue. The passing remarks in Nordenfelt's case on the issue of trade secrets were made only in the Court of Appeal and were to the sale of trade secrets only. It would therefore seem to be a reasonable supposition that the standard required to qualify as a trade secret may be higher in the case of an employer wishing to exercise a constraint over an employee than in instances where a purchaser of a business has a constraint over the vendor. In fact, this is but a corollary to what Morris v. Saxelby states directly, namely, scope must be given to an employee to use his ordinary knowledge and skill, his "subjective" knowledge, in later employment.

The question that is not answered in cases with a restraint of trade emphasis before and after Morris v. Saxelby, nor answered in Morris v. Saxelby itself is: what are the peculiar qualities of a trade secret that distinguish it from the "subjective" knowledge of an employee and thus merit protection? The mass of information that Herbert Morris Ltd. had assembled no doubt required many man hours and much trial and error to produce and clearly would have been useful to a competitor. Yet, familiarity

<sup>113</sup>(1869) L.R. 9Eq. 345.

with this information by the employee was held to be "subjective" knowledge that could be used elsewhere. What magic difference is there in a trade secret that should lead to "subjective" knowledge not being open to the same treatment?

Whatever answers can be supplied for the above questions there is a significant point that emerges. It is probably a waste of time to search for a universally applicable definition of a trade secret. When a sale of a business takes place and a restraint is accepted by the vendor, it does not matter where the line is drawn between confidential information and trade secrets because the vendor should not be permitted to use matters within either category in competition with his purchaser. A generous interpretation of what constitutes trade secrets will not lead to an error in the result. A narrower interpretation of what constitutes a trade secret may be appropriate when the situation under consideration involves transfer of information under an arrangement negotiated at arms length where transfer of information is the *raison d'etre* of the relationship. Then the narrowest interpretation of the scope of a trade secret is appropriate when an employer-employee relationship is under consideration.

This argument is open to the criticism that great uncertainty can emerge from such an approach. The uncertainty could lead to the seeming absurdity of the very same

piece of information being susceptible to protection as a "trade secret" in some instances, but not in others. This criticism is well based. In fact, without there being any recognition of why it is occurring, that is just what has been occurring in case after case with unpredictability being the only certainty. There is no way this can be avoided if recognition is to be given to an employee's ordinary skill, experience and knowledge.

#### 5. Problems Arising through Intangible Nature of Trade Secrets.

The lack of consistent policy objectives leads to many problems in the trade secret field, some of which have already been discussed. There are further problems arising through the difficulty of fitting trade secrets into the framework of the traditional streams of law due to the intangible and fragile nature of trade secrets.

At various times "theories" have been put forward as supporting the protection of trade secrets. Analogies have been made with aspects of property law. Remedies similar to those found in the law of torts have at times, been advanced and at other times, contract law is used.

There are difficulties to be found in applying property concepts to the mainstream industrial and intellectual



property, patents, copyright and design. These difficulties are magnified in the case of trade secrets. If there is an unauthorised using of material embraced by a patent, copyright or design, there are comparatively straight forward remedies available to restore matters to an approximation of the status quo before the unauthorised using. With trade secrets, however, once they have made a full escape through unauthorised use they can never be recaptured. As loss of a trade secret represents a loss of a competitive advantage that cannot be restored, damages will be extraordinarily difficult to calculate, because of the multitude of intangibles that go into the make-up of a competitive advantage. Accordingly, an injunction, if it can be gained before the escape of the secret is complete, will be the most satisfactory result and in many instances the only satisfactory result for a trade secret holder.

An injunction against revelation of a secret<sup>2</sup> will avoid the near insurmountable problem of dealing with the case of a bona fide purchaser for value of trade secret "property" which is to be transferred by a vendor who was not authorised to do so. If an injunction is not gained before the unauthorised transfer, some very real inequities can arise if an injunction is granted against the transferee because there is no way that he can reasonably cleanse himself of the secret transferred.

When there is a situation where the person to whom a secret is transferred is not completely unaware of the possible origins of the trade secret there are still very real problems. As far back as Morison v. Moat<sup>114</sup> it was established that the person receiving a trade secret through an unauthorised communication of it could have an injunction made against him restraining his use of the secret. In later times the tort of inducing a breach of contract (of Lumley v. Gye<sup>115</sup> origins) has been invoked to justify the issue of an injunction against the use of a trade secret by someone who has acquired it from an ex-employee of the initial trade secret holder. There will be some instances where a restraint will be quite appropriate. In Morison v. Moat itself, on the finding on facts, the defendant would have been very well aware that his father was bound by the partnership agreement to refrain from revealing the secret and the matter covered by the secret would have been well known also. In some situations, the tort of inducing a breach of contracts could be established along traditional lines because the recipient of the secret will be aware of the existence of the secret and will deliberately design its revelation. There are other frequently encountered situations, however, where an allegation of inducing a breach of contract should be quite out of place. These are situations where a person who has been working in a technically

<sup>114</sup> (1851) 9 Hare 241; 68 E.R. 492.

<sup>115</sup> (1853) 2 E. & B. 216; 118 E.R. 749.

advanced area changes employers and, despite the fact that new employer and employee alike are anxious to avoid legal entanglements, the employee makes use of what is thought to be his own experience and knowledge but, with the wisdom of later judicial interpretation, discovers that he has been applying trade secrets as well.

A response that has been advanced to the above dilemma is to endow the new employer with constructive knowledge that secrets may be revealed to him. Unfortunately, this throws the new employer into a further quandry. If he made a thorough enquiry on the differences between his operations and that of his rival employer to determine the trade secrets known by his new employee he will have the trade secrets revealed to him and will therefore have to take what steps he can to avoid using them. Alternatively, he will use the new employee in fields quite distinct from his previous experience with obvious lowering of the employee's usefulness. The only other reasonable choices available are to refrain from recruiting people with experience in the field or make a gentleman's "knock-for-knock" arrangement with major competitors. Probably it is from these last two practical solutions that choices have been made in many industries in that the reports are almost empty of any employee orientated trade secret cases between major firms in technologically advanced industries. Litigation is almost inevitably restricted to action being taken against an ex-employee moving to a position



of private consultant or moving to a firm that is attempting to enter the market.

There are difficulties in finding appropriate analogies to trade secret actions in the fields of property, tort, contracts and anomalies in any adaption. The major problems arise, however, at the next stage in determining a remedy. On the one hand, anything other than an injunction is unlikely to lead to satisfaction to a trade secret holder who is anxious to retain his secret but on the other hand, an injunction is a very clumsy tool to apply in the trade secret area. Very pithy comments were made of their lack of suitability by Lord Eldon in 1817<sup>116</sup> and little has changed since those comments were made.

Speed is often a major consideration when a trade secret holder fears that unauthorised revelation of his secret is about to take place. Therefore, an interlocutory injunction will often be sought to minimise the chance of the trial being reduced to the status of an autopsy on the secret. An interlocutory injunction will tend to inconvenience and embarrass a defendant in any field. In the trade secret field where an ex-employee is restrained from doing anything in the way of using or disclosing the alleged secret the financial embarrassment is likely to be very great whilst the trial is being

<sup>116</sup>Supra note 42

awaited. Probably this is a very material factor in matters not proceeding further. A United States commentator on the topic has observed that in the great majority of cases, a matter will not go to trial if an interlocutory injunction is obtained.<sup>117</sup>

Despite the fact that the interlocutory injunction proceedings will very often be the first and last time that the matter will be in court the matter will, as usual for such matters, be decided on the motion only. Hence most complicated matters relating to what secrets, if any, may be in existence and what knowledge of the employee is available for his own use are decided with the minimum of examination. These matters would be difficult enough on their own, but the difficulties are compounded by the normal practice of plaintiffs in avoiding specificity in indicating secrets wherever possible. Justification of this practice has been argued by plaintiffs on the basis of avoiding revelation to the employee and possibly the employee's new employer of trade secrets that are not already known.<sup>118</sup>

There now appears to be growing opposition by the courts to broadly stated interlocutory injunctions. This has been reflected in some instances by an insistence that better

<sup>117</sup> T. Arnold and B. Durkee "Trial Tactics in Trade Secret Cases" in "Protecting Trade Secrets Today", Practising Law Institute 1973; page 379.

<sup>118</sup> Printers & Finishers Ltd. v. Holloway [1965] R.P.L. 239; [1964] 3 All E.R. 731.

particulars<sup>119</sup> be supplied to the defendant. In other instances interlocutory injunctions have been refused<sup>120</sup> or injunctions that have been granted have been set aside on appeal on the grounds of being too widely stated and lacking in specificity.<sup>121</sup>

On questions of the level of detail required in particulars and the appropriateness of granting an interlocutory injunction, there is necessarily wide scope for the exercise of discretion and hence substantive law is laid down infrequently. A substantive point did emerge in the recent decision of the House of Lords in American Cyanamid Co. v. Ethicon Limited<sup>122</sup> which, if applied generally in trade secret cases could lead to grave consequences. The case involved the granting of an interlocutory injunction in a patent infringement case, but the House of Lords took the opportunity to lay down general guidelines on the principles upon which the discretion to grant interlocutory injunctions may be based. Lord Diplock, with whom the other Lords expressed concurrence, stated that despite the practice that had developed over the years, there was no rule requiring the plaintiff to establish a prima facie case before the question of the balance

<sup>119</sup> John Zink Co. Ltd. v. Wilkinson [1973] R.P.C. 717.

<sup>120</sup> Caristrap Corp. v. Cordex (1967) 50 C.P.R. 201 (Ontario High Court);

<sup>121</sup> See generally Sulner & Co. A.G. v. Transradio Ltd. [1967] R.P.C. 329; Technograph Printed Circuits v. Chalwyn Ltd. [1967] R.P.C. 339; Corica v. Ragen 140 F (2d.) 496 (1944) - a case ahead of its time that is now being remembered; E.W. Bliss v. Struthers-Dunn Inc. 408 F (2d.) 1108 (1969).

<sup>122</sup> [1975] 2 W.L.R. 316; [1975] 1 All E.R. 504.



of convenience in granting or refusing the injunction was considered. As long as the claim did not appear to be frivolous or vexatious the only question was that of balance of convenience. The House of Lords went on to restore the order granting the injunction that the Court of Appeal had set aside.

In trade secret cases, due to the fragile character of a secret, the balance of convenience will almost always be found to be in favour of granting an injunction. The plaintiff is very likely to be in the financial position to post damages as security lest they be later due because the interlocutory injunction is shown to have been unwarranted. On "balance of convenience" assessment the potential financial embarrassment to the defendant has normally been given low priority.

Possibly there will be some restrictions placed on the broad scope of the decision in American Cyanamid. The Court of Appeal in Fellowes v. Fisher<sup>123</sup> had to follow the ruling but this was not without Lord Denning expressing strong criticism of the case and pointing to its inconsistency with the House of Lords decision in Stratford v. Lindley<sup>124</sup> where there is dicta stating that a prima facie case must be established before an interlocutory injunction will be ordered. Certainly in the recent past, applications for injunctions have been refused

<sup>123</sup> [1975] 2 All E.R. 829

<sup>124</sup> [1965] A.C. 269; [1964] 3 All E.R. 102.

where a prima facie case has not been established - vide

United Sterling Corp. Ltd. v. Felton and Marion,<sup>125</sup> Jiffy

Foods Ltd. v. Chomski,<sup>126</sup> Diamond Stylus Co. Ltd. v. Bauden

Precision Diamonds Ltd.<sup>127</sup>

Another problem arising from the peculiar character of trade secrets is that a defendant ex-employee is likely to be severely hampered in the preparation of his case when an interlocutory injunction is made against him. This is because the order will probably restrain him from disclosing any secrets. He may run a real risk of being in contempt and therefore wrong-footed to an even greater extent if, in attempting to prepare his case, he discloses what may later be categorised as trade secrets. On occasions when the ex-employee has joined another employer an injunction may be made against the employer discussing secret information with the employee. This can have the effect of virtually crippling the defence. The new employer may have the technical and financial resources to mount a proper defence that denies that there are any trade secrets being used by the plaintiff. These resources will be of little aid if information is not made available through particulars being supplied in some detail and the ex-employee being available to discuss what he knew of the plaintiff's operations.

<sup>125</sup> [1974] R.P.C. 162

<sup>126</sup> (1973) 9 C.P.R. (2d.) 1.

<sup>127</sup> [1973] R.P.C. 67C.

An additional complication in resolving matters fairly is likely to arise if a defendant claims that he is not making use of the plaintiff's trade secrets - the existence of which, in any event, is denied - but is conducting his processes with his own trade secrets. The skirmish which is then likely to take place with inspections and detailed particulars being denied by two parties will tend to worsen the position of an ex-employee who claims that he wishes to use only his own skill and knowledge. The case of Terrapin Ltd. v. Tecton Structures Ltd.<sup>128</sup> provides an illustration of the problems that can arise when alleged secrets are held by two contestants. The order made at lower level was the subject of an unsuccessful appeal by the plaintiff who claimed that independent experts would not be capable of making a reasonable assessment and that the plaintiff should be permitted to make his own inspection.

Following the interlocutory injunction stage a permanent injunction may be sought and gained. This gives rise to another problem related to the peculiarities of trade secrets. It may be satisfactory to award a permanent injunction to refrain from infringing a patent because the "permanency" will last only for the residue of the term of the patent. With a trade secret there is no clear time limit and a permanent injunction will be

<sup>128</sup> (1967) 59 W.W.R. 374 (Brit. Col. Supreme Court); (1968) 64 W.W.R. 129; (1969) 39 Fox P.C. 38 (Brit. Col. Court of Appeal).



fruly permanent. This could not be justified in restraint of trade terms because normally a reasonable time limit must be stipulated. It can find even less justification when a "springboard" test is invoked to give a trade secret categorisation to comparatively pedestrian technological information which will be part of common knowledge in the industry within a few years. At times, courts have recognised this factor and ordered an injunction for only until such time as the secret remains a secret.<sup>129</sup> An interesting example of this is to be found in Hampton v. Blair Manufacturing Co.<sup>130</sup> where it was held that the defendant would have taken less time to work out the secret for himself than the time that the case had taken to come onto trial and therefore concluded that an injunction was no longer appropriate. Awareness of the limited life of a trade secret is far from universal, however, and the courts frequently aware permanent injunctions seemingly without considering the merits of a lesser period.

#### 6. Future Common Law Developments in Trade Secret Law.

With respect to express and implied conditions in contracts of employment, symptoms will no doubt continue to appear of the clash between the interests of employers who wish to minimise the harm that can arise to them through information

<sup>129</sup> International Tools Ltd. v. Kollar [1968] 1 O.R. 669 (C.A.)

<sup>130</sup> 374 F (2d.) 969 (Eighth circuit, 1967).

transferring to competitors and the interests of employees and the public at large in the employee being able to make use of his skill, knowledge and experience in other positions. The lack of recognition of this being a central issue is reflected in the fact that it is still not clearly resolved as to whether an employee may make use of matters in his memory.<sup>131</sup> If one approaches the problem with the view that trade secrets are in all circumstances worthy of protection, then no sensible distinction can be drawn between matters which need to be recorded and matters which a person with a retentive memory can take away without reducing the material to a durable form. If the opposite viewpoint is taken and restraints on the use of an employee's ordinary skill, knowledge and experience are not acceptable, then if information is held in the memory due to continued association with the information this should be taken as a part of the "subjective" knowledge of the employee.

<sup>131</sup> Some cases in which material retained in memory mentioned as part of employees own knowledge: Sir W.C. Lang & Co. v. Andrews [1909] 1 Ch.D. 763, 773; Morris v. Saxelby [1916] 1 A.C. 668, 702; United Indigo Chemical Co. Ltd. v. Robinson (1932) 49 R.P.C. 178, 186; Sarkes Tarzian Inc. v. Audio Devices Inc. 166 F. Supp. 250 (S.D. Calif. 1958).

To the opposite effect, dicta in Amber Size & Chemical Co. Ltd. v. Menzel [1913] 2 Ch.D. 239; British Celanese Ltd. v. Moncrieff (1948) 65 R.P.C. 47; Terrapin Ltd. v. Builders Supply Co. (Hayes) Ltd. [1967] R.P.C. 375, 390.

Of course this can lead to the occasional evidentiary problems but if material is of a detailed nature and it would seem unlikely that it would be retained in the memory through normal carrying out of employee functions, then a claim that memory alone was used can be rejected either because it is not believed that a memory could be so good or because it would have to be a deliberate use of memory for purposes other than the service of the employer.<sup>132</sup>

There will be problems in permitting the normal use of memory but rejection of its use lead to even greater problems. Such problems could arise in an area that has been quite sensibly avoided - the use of knowledge of trade secrets to avoid pitfalls. Assume an engineer or some similarly skilled person has been engaged in a long series of tests to arrive at a practical solution to a problem. This solution may well be a trade secret on any criteria. If the engineer moves to another employer he may well be presented with the same problem. Will it be an unauthorised use of the trade secret if the engineer refrains from running the whole series of tests again because he remembers full-well the approaches that were failures? Supposing a court is pressed to make a decision on this matter it is hardly likely to order the tests to be continued so that the result can be rediscovered. Yet the alternative, namely permitting short cuts to be taken to the tests that the engineer

<sup>132</sup> A similar approach to this, although with a change in accent is to be found in Printers & Finishers Ltd. v. Holloway [1965] R.P.C. 239, 256.



remembers were fruitful will allow a rapid catch-up by the engineer's new employer. Unsatisfactory as the latter decision may be, it is the preferred decision and it will probably be reached with the justification that the employee will be making use of his ordinary skill and experience.<sup>133</sup>

A distinction has often emerged, generally implicitly, on the use of memory of names of customers by a person involved in direct customer contact. Strictly this would only be applicable where names have a confidential aspect.<sup>134</sup> Rather than permitting cases involved with these situations to confuse the issue as to what can be used by an employee in the way of ordinary skill and knowledge, it would seem preferable to regard the personal contacts as the essential factor that may be protected. Thus the ordinary skill and knowledge in technical matters may be seen to be parallel only to the knowledge of techniques useful in gaining and maintaining customers. These techniques should be available for use elsewhere but possibly the goodwill aspects tied up in direct contact with customers of the employer should remain with the employer.

<sup>133</sup> For a case throwing up these types of problems but going the other way on material differences in facts Reid & Sigrist Ltd. v. Moss & Mechanism Ltd. (1932) 49 R.P.C. 461.

<sup>134</sup> c.f. Greening Industries Ltd. v. Penny (1966) 53 D.L.R. (2d.) 643 (N.S.S.C.) where names of customers were held to be non confidential and hence no objection at all could be made to them being remembered.

There appears to be a trend, particularly in the United States of America to give greater accent to the need for an employee to make use of his ordinary skill, knowledge and experience and the scope of these qualities is being interpreted more broadly. Initially regarded as an aberration from the normal rules, the approach taken in the case of Wexler v. Greenberg<sup>135</sup> has been regarded with greater sympathy of late.<sup>136</sup> As well as giving a reasonable breadth to an employee's skills, it was stated in this case that<sup>137</sup>

"Were we to measure the sentiment of the law by the weight of both English and American decisions in order to determine whether it favors protecting a business-man from certain forms of competition or protecting an individual in his unrestricted pursuit of a livelihood, the balance would heavily favor the latter. Indeed, even where the individual has to some extent assumed the risk of future restriction by express covenant, this Court will carefully scrutinize the covenant for reasonableness "in the light of the need of the employer for protection and the hardship of the restriction upon the employees"."

In a similar vein there is the following dicta in the Privy Council decision in Stenhouse Australia Ltd. v. Phillips:<sup>138</sup>

<sup>135</sup> 160 A (2d.) 430 (Pa.Sup.Ct. 1960); 125 U.S.P.Q. 471.

<sup>136</sup> Vide: Winston Research Corp. v. Minnesota Mining & Mfg. Co. 350 F (2d.) 134 (Ninth Circuit 1965); Metal Lubricants Co. v. Engineering Lubricators 411 F (2d.) 429 (Eighth Circuit 1969) Wilson Certified Foods Inc. v. Fairbury Food Products 370 F. Supp. 1081 (Neb. 1974).

<sup>137</sup> 160 A (2d.) 435

<sup>138</sup> [1974] 1 All E.R. 117, 122.



"The accepted proposition that an employer is not entitled to protection from mere competition by a former employee means that the employee is entitled to use to the full any personal skill or experience even if this has been acquired in the service of his employer: it is this freedom to use to the full a man's improving ability and talents which lies at the root of the policy of the law regarding this type of restraint. Leaving aside the case of misuse of trade secrets or confidential information (which is separately dealt with by Cl.3 of the agreement and which does not arise here), the employer's claim for protection must be based on the identification of some advantage or asset inherent in the business which can properly be regarded as, in a general sense, his property, and which it would be unjust to allow the employee to appropriate for his own purposes, even though he, the employee, may have contributed to its creation. For while it may be true that an employee is entitled - and is to be encouraged - to build up his own qualities of skill and experience, it is equally his duty to develop and improve his employer's business for the benefit of his employer. These two obligations interlock during his employment: after its termination they diverge and mark the boundary between what the employee may take with him and what he may legitimately be asked to leave behind to his employers."

A disappointing aspect to this passage is that trade secrets are mentioned but are in no way defined. Definition was not necessary as they were not in any way relevant to the case because it involved an insurance broker's client contacts and it seems that trade secrets were mentioned only



because a standard form style of contract had been used. What is of main interest is the heavy accent given to the need to give scope to an employee's skill and experience. This may have the effect of limiting the scope of what may be categorised as "trade secrets" which are susceptible to full retention by an employer.

Such a trend would fall within the spirit of the much more rigorous approach to restraint of trade matters since Esso Petroleum Co. Ltd. v. Harper's Garage (Stourport) Ltd.<sup>139</sup> The Esso case can be characterised as putting new life into the long dormant public interest consideration in Lord Macnaghten's test stated in the Nordenfellt case. Just as significant was the accent that Esso gave to balancing the interests of covenantee and covenantor rather than concentrating almost exclusively on the protection that a covenantee may reasonably require. As it was with the latter concentration that much of trade secret law emerged some change in priorities may arise on a reassessment in the light of the Esso case.

A significant step beyond the decision taken in the Esso case was made in MacAulay (previously Instone) v. A. Schroeder Music Publishing Co. Ltd.<sup>140</sup> a decision of the House of Lords which has already been followed by the Court of

<sup>139</sup> [1968] A.C. 269; [1967] 1 All E.R. 699.

<sup>140</sup> [1976] 1 W.L.R. 1308

Appeal in Clifford Davies Management Ltd. v. W.E.A. Records.<sup>141</sup>

In these cases what appears to have been the standard form used by music publishers in their agreements with composers came under examination. The key terms specified that the composer was to submit all musical compositions to the publisher over a five year period with the publisher to have copyright vested in him and the composer to be paid royalties on the use of the music if the publisher decided to use it. At the option of the publisher the agreement could be renewed for a further five years on the same terms at the end of a five year period.

The House of Lords held that an agreement of this nature could be classified as one to which the doctrine against restraint of trade could be applied. This was an advance on the Esso case although not directly of relevance to the trade secret field. What is of relevance to trade secrets was the heavy accent given to the burdens that the agreement placed on the covenantor and the conclusion that such burdens were oppressive and therefore the restraints should not be enforced.

It was in Morris v. Saxelby<sup>142</sup> that clear recognition was first given to the need to allow an employee the opportunity to use his "subjective" knowledge upon leaving an employer. But in recognising this, the terms were most guarded. Lord Parker stated that a weighing of the advantages

<sup>141</sup> [1975] 1 W.L.R. 61.

<sup>142</sup> *Supra*

accruing to the covenantor under a contract as against the disadvantages imposed upon him by the restraint was impractical and that a court would not consider the adequacy of the consideration in any particular case.<sup>143</sup> It is quite clear from the MacAuley case that this limited perspective has been put aside.

In MacAuley's case the plaintiff had argued that the terms of the agreement should be regarded as reasonable as they were quite usual terms in the trade. This had quite often been accepted in the past as persuasive and in the Esso case usual terms in the trade were examined when considering reasonableness. In MacAuley's case, however, it was stated that such an argument should be applicable only if it was shown that standard contract terms had emerged from arms' length negotiation between parties of comparable bargaining strength and this had not been demonstrated. A willingness to put aside contractual conditions when there is an inequality of bargaining power is indicated in a slightly different context in the Court of Appeal's decision in the case of Lloyds Bank Ltd. v. Bundy.<sup>144</sup> The thrust of this decision would find a ready application in situations where restraints may have oppressive characteristics.

The extent to which the recent moves in England on restraint of trade matters will affect Canadian courts is not known. After the Esso case was decided, the Supreme Court of

<sup>143</sup> [1916 A.C. 688, 707

<sup>144</sup> [1974] 3 W.L.R. 501; [1974] 3 All E.R. 757



Canada heard an appeal from the Quebec Court of Queen's Bench - Appeal Side<sup>145</sup> in Canadian Factors Corporation Ltd. v. Cameron.<sup>146</sup> The case involved some very rigid restraints in the contract of employment of the office manager of a factoring concern. The Court of Queen's Bench, by a majority, decided against the defendant by an application of the Quebec Civil Code and by common law principles. Its decision was before the Esso case was decided, but Nordenfelt's case was discussed on the basis that it extinguished the rule making restraints of trade invalid.<sup>147</sup> No specific comment was made on this perspective of the law in the judgment of Laskin J. in his majority decision for the Supreme Court in reversing the lower courts decision. Strangely, the Esso case was not mentioned in the Supreme Court's decision, although the decision is in accord with the approach of that case on both the interpretation of the relevant public order provisions of the Civil Code and on common law principles.

An earlier decision of the Supreme Court of Canada which is based on misuse of confidential information implies an approach that could be adopted to avoid some of the difficulties arising in the trade secret - confidential information area. In Pre-cam Exploration & Development Ltd.

<sup>145</sup> (1967) 49 C.P.R. 101 (Quebec).

<sup>146</sup> [1971] S.C.R. 148; 1 C.P.R. (2d.) 114; (1971) 18 D.L.R. (3d.) 374

<sup>147</sup> (1967) 49 C.P.R. 117

v. McTavish<sup>148</sup> the defendant had been engaged as an employee of the plaintiff to conduct some exploratory work on mineral claims. Whilst carrying out the work the defendant discovered that the mineralized zone appeared to continue beyond the currently staked claim. The defendant put in his resignation and then staked claims for himself in the areas where the mineralized zone continued. In the normal course these additional areas would have been staked for the defendant's employers in the name of the person who was paying for the exploration work to be carried out.

At trial, it was held that the defendant had no right to stake the claims for himself and that they were acquired by him for his employer and hence for the person who had contracted with his employer.

The defendant's appeal to the Saskatchewan Court of Appeal was allowed<sup>149</sup> with it being held by a majority that there was no implied condition of the contract of employment placing the appellant in a fiduciary position such that any knowledge acquired in his employment could be used only for his employer after his employment terminated. This decision was dissented to by Hall J.A. and as the Supreme Court later agreed with his view the approach he took merits attention.

<sup>148</sup> (1966) 56 W.W.R. 697; [1966] S.C.R. 551; (1966) 57 D.L.R. (2d.) 557

<sup>149</sup> (1965) 53 W.W.R. 662; (1966) 55 D.L.R. (2d.) 69.

After making general remarks on the use of information gained in confidence, Hall J.A. referred to the sketch taken by the defendant during the time of employment and the way that advantage had been taken of his employer's previous work and expense in setting up the survey. He said:<sup>150</sup>

"While still employed he planned and prepared to stake the claims in question. The result of such planning and preparation was to defeat the whole purpose of (the plaintiff's) enterprise which was to stake the claims necessary.... (The defendant) thus used the term of employment to further his own interests in complete disregard of his employer. This was clearly a breach of his obligation to serve his employer with good faith and fidelity. The final act of staking, the culmination of the breach of obligation, is not made innocuous by the intervening formality of resignation."

The Supreme Court of Canada in a judgment delivered for the court by Judson J. allowed the appeal and restored the judgment at trial. No cases are cited in the judgment with there being no explicit statements of law advanced. It was stated that the defendant could not use such information to his own advantage and as the severance of the employment could only be regarded as an empty formality the claims that had been staked were to be regarded as held in trust for the plaintiffs.

This case could be characterised as one based on rules relating to confidential information with adaptations being available to trade secrets. It would seem more direct an approach however, to view the situations along the line which was selected



by the Saskatchewan Court of Appeal and acted as the division between the majority and minority. That is, it should be a question of construction of the contractual obligations of the employee. This goes right back to where Robb v. Green<sup>151</sup> started. What this would involve would be determination of what were the functions and duties of the employee (or agent or director of a company) and decide the way certain material should be handled in the light of these functions and duties. By such an approach one may become embroiled with difficulties in characterising the nature of the information at issue and determining the responsibilities of the employee with respect to this information. What would be avoided would be the approach that now brings so much confusion into the area because the initial objects of the exercise have been forgotten. That is, with a formula along the lines: all employees have an implied duty to use for the employer exclusively all X (= confidential information) and Y (=trade secrets), many problems occur as attempts are made to modify the nature of X and/or Y in order to avoid placing a burden on the employee that is too heavy in the circumstances and in order to avoid restraining trade to too great an extent. When a wide interpretation is given to X and/or Y in one context it tends to move into the digests and texts in that form and be applied to situations for which it was not initially designed. This is even without taking into

<sup>151</sup> [1895] 2 Q.B. 315; *supra*

account the many situations other than employer - employee relationships to which these factors have been applied.

In the Pre-cam Exploration case itself one could put aside "confidential information" notions almost completely and ask what was the defendant's task as an employee? If one made the reply: to return to the employer the specific material requested; the conclusion then should be that the employee was free to use his additional observations for himself. It was this conclusion that, in effect, was reached by the majority of the Saskatchewan Court of Appeal. If instead one gives a different reply to the question and says that the function of the employee was to return to the employer with specific material together with material that a person with his functions could clearly see to be related to the performance of his employer, then one emerges with the same conclusion as the Supreme Court of Canada. This would be an approach closely related to rules used in the law of principal and agent. It would be similar to the old cases on unauthorised acts that were decided before the law on trade secrets and confidential information evolved as a supposedly separate branch of law.

The recommended approach could be effectively applied to fact situations such as those arising in Cranleigh Precision Engineering Ltd. v. Bryant.<sup>152</sup> The facts were

<sup>152</sup> [1965] 1 W.L.R. 1293; [1964] 3 All E.R. 289.

complicated, involving as they did squabbles that arose when the founder and managing director of a private company was squeezed out of the company by persons who were brought in for their capital. The defendant as managing director and inventor of improvements in above-ground swimming pools had made an application for a patent for the improvements. He had been told by the company's patent attorneys that the Patent Office had reported that the application was anticipated by an earlier patent. He said nothing of this to the other directors of the company. After termination of his connection with the plaintiff company, the defendant acquired the patent that had constituted an anticipation of his patent application. He then commenced manufacturing swimming pools in competition with his old company and, enjoying a momentary triumph, threatened infringement action against the plaintiff company for the pools it was manufacturing.

The plaintiff company brought a successful action that had the result of pushing the defendant right out of the business and an order was granted preventing the defendant from using the patent he had acquired to bring an infringement action against the plaintiff. The result may be appropriate, but the route taken by Roskill J. to reach the result brought further mystery into the confused area of confidential information/trade secrets. Inter alia it was necessary to rule that knowledge



of a published patent specification was confidential information when the knowledge was held by someone with the defendant's awareness of its implications. The application of the Saltman Engineering<sup>153</sup> case and its singularly apposite "springboard" test resulted in knowledge of various features of the plaintiff's pools (which had been marketed for some time) being characterised as information that the defendant was not permitted to use and so too was any knowledge of pricing and potential profits.

A very real difficulty could have arisen with the approach adopted by Roskill J. if the defendant had, say, revealed to the other directors of the company the patent anticipation problems and the directors had refused to act. On the confidential information - trade secret approach the defendant would have still been prevented from doing as he did. Perhaps the situation would have become quite silly if the defendant had advised the directors of the patent problem, left the company and designed pools with characteristics that avoided infringing the patent which remained in the hands of the outside their person. If the plaintiff company then suffered a set-back due to infringement action being taken it could be claimed by the company that the defendant had moved ahead in the market by using the information which Roskill J. characterised as information that could not be used by the defendant. The appropriate order in such

<sup>153</sup>(1948) 65 R.P.C. 203; [1964] 3 All E.R. 413; *supra* note 15.

an instance is not easy to envisage.

It is submitted that a reasonable way around these problems would be to look to the duties of a managing director. It would seem that the defendant Bryant, as a managing director charged with the task of protecting the company's affairs, should be obligated to take whatever steps may be available in avoiding a potential patent infringement action. Reporting the matter to the other directors may have been sufficient to cover his minimum obligations. There is much law available on a company director's duties vis a vis the company and whilst application of the law to various fact situations may not be easy, it should be easier than inventing almost free-standing rules on confidential information and trade secrets.

Much of the foregoing would return the law to the position towards the end of the nineteenth century as sketched under the heading 3. above "Evolution of Trade Secret Law". The de facto copyright cases of that time are to a large extent now embraced by modern Copyright legislation. Making copies of information, or the taking of charts, tables and other documents for the purposes of use elsewhere would very rarely be part of an employees duties and hence could not be authorised. Similarly, a special seeking-out of information that is not related to an employee's duties would constitute an

unauthorised act and, as in the old cases, use of such information would not be permitted. Any information acquired in the normal course of duties would become part of an employees ordinary skill, knowledge and experience that should only be restricted in use if such use would conflict with carrying out the task for which the employee was engaged.

Such an approach would increase the transfer of information but use of patents where material is patentable could be used.

Trade secrets may be handled differently in instances of sale of trade secrets, for here there are analogies to the sale of goodwill and some restraints on the vendor can be readily justified.

Licensing of trade secrets is in an awkward middle ground in that in some instances the licensing will be close to situations where there is an outright sale and in other situations licensing will be closer to the employer - employee relationships. It will often be the case that a licensing of trade secrets will be done on the basis that the licensee will place his employees under an obligation not to reveal or use the secret elsewhere. The question of what is reasonable in licenses thus becomes closely related to what is reasonable in employer-employee restraints.

It is unlikely that there would be any early clarification of the trade secret area if the matter is left to evolution of common law principles. Legislation would seem to



be necessary to erase some of the more deeply embedded common law principles that conflict with policies expressed and implied in the patent field and the field of competition policy. Clearly value judgments will be required as to what balance is desirable in an attempt to resolve these conflicts. Some of the problems to be faced in any proposed legislative intervention will now be briefly canvassed.

#### 7. Possibility of Legislation on Trade Secrets

Any legislation that may be contemplated in the trade secret field in Canada will have to conform with the dictates of the division of power between the Parliament and the Provinces set out in the British North America Act. The Parliament is clearly vested with powers to legislate on patents and, of course, has expressed these powers. The relevant clause of Section 91 of the B.N.A. Act is 22 which states "Patents of Invention and Discovery". What is meant by "and Discovery" is not known. It would be a forced construction, it seems, for the phrase to be read disjunctively from "Patents of Invention" but if such a construction was to be accepted, trade secrets could fall within it. There could be quite a strong argument made, however, that legislation could be validly made setting out the rights and limitations on the rights of trade secrets without adopting a disjunctive construction.

In the U.S.A. it was held by the Sixth Circuit in the case of Kewanee Oil Co. v. Bicron Corporation<sup>154</sup> that

<sup>154</sup> 478 F 2d. 1074 (1973)

the federal power with respect to patents pre-empted the excuse by a state of legislation affecting trade secrets. This decision was reversed by the U.S. Supreme Court.<sup>155</sup> In doing so, however, the Court was concerned with the issue of whether it was an implied aspect of the Federal patent power that matters that could be subject to patent prosecution could be protected by patents alone. It is possible that in the Canadian context the same result could emerge if the provinces introduced legislation protecting trade secrets.

The relevant provision<sup>156</sup> of the U.S. Constitution grants to the Congress the power -

"To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries . . ."

The clear policy aspects built into this provision ("to promote") prompted an analysis of the function that could be served by patents and the limitations that may therefore be impliedly placed on trade secrets. What the Supreme Court was not required to determine was the status of state trade secret law if Congress specifically introduced legislation placing limits on trade secret rights. It would seem that it was open for Congress to enter this field to at least some extent and any state law inconsistent with such legislation would be invalid.

<sup>155</sup> 416 U.S. 470 (1974)

<sup>156</sup> Article I, S 8, Cl. 8.

Whilst paramountcy issues tend to be more complicated in Canada than they are in the U.S.A. the same result would possibly occur. This is providing that whatever trade secret law is introduced is within Parliament's powers and no explicit ruling in the U.S.A. gives any guidelines on how far the "patents" power may go.

Trade secrets have some common features with trade marks and the fact that Parliament's trade mark legislation has by and large survived, despite the lack of a specific clause in Section 91 covering trade marks augurs well. The recent decision of the Supreme Court of Canada in John A. MacDonald v. Vapor Canada Limited<sup>157</sup> indicates that great care will need to be exercised in drafting valid legislation on trade secrets unless trade secrets can be brought within "patents of invention and discovery".

The Vapor Canada case was based on Section 7(e) of the Trade Marks Act. This provision reads:

"No person shall

(e) do any other act or adopt any other business practice contrary to honest industrial or commercial usage in Canada"

The context in which this provision appears would seem to limit it to "passing-off" types of activity but nonetheless it had been interpreted by the Federal Court to include unauthorized use of trade secrets. The Supreme Court by examining the lack of any systematic way in which the provision could be enforced

<sup>157</sup> Judgment delivered 30 Jan. 1976, not yet reported



and the local nature of activities that it could embrace concluded that it fell neither under the trade and commerce clause - S.91(2), or the criminal law - S.91(27). It would seem that setting up appropriate machinery for controlling trade secrets may avoid these problems.

Whatever constitutional difficulties do lie in wait for legislation on trade secrets it would appear extremely desirable on the grounds canvassed earlier that trade secrets and patents be handled by the one body and hence interlocking legislation is desirable.

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